



**ROYAL COMMISSION INTO MISCONDUCT IN THE BANKING, SUPERANNUATION AND
FINANCIAL SERVICES INDUSTRY**

**Submission of National Australia Bank in response to the issues and questions that
have emerged in the Interim Report**

Andrew Thorburn
Group CEO

700 Bourke Street
Docklands VIC 3008
Australia



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The Honourable Kenneth Hayne AC QC
Commissioner, Royal Commission into the Banking, Superannuation and Financial Services Industry

Dear Commissioner

The Royal Commission has been a deeply confronting experience for the banking sector and has challenged us at an industry, enterprise and individual level. It has exposed issues, both at NAB and more broadly, that have been upsetting and disappointing. I have personally felt this deeply, having worked in our profession for more than three decades. Our 33,000 people are also feeling it. These include tellers, small business bankers, agri bankers, corporate bankers, and support teams, such as our people, technology and operations divisions. The vast majority of them do the right thing, serve our customers well and act with integrity.

I was not, initially, in favour of the establishment of a Royal Commission. I was wrong. I am now firmly of the view that it is not only an appropriate, but necessary, inquiry to provoke critical self-examination by financial services companies and to drive change for customers. Your thorough examination has been a significant learning experience for NAB and for me personally. It has caused me to reflect on where we have gone wrong and why we have drifted away from our customers. I have also considered how at NAB we can address those issues in a meaningful and sustainable way.

The submission which follows has been prepared in this spirit. It is forward-looking and focuses on the long-term. Your interim report is fair and balanced, and poses many important questions of policy and practice. In responding we have challenged ourselves to think deeply and differently about current industry norms, as well as our own sometimes long-held positions and practices.

Regulation alone cannot achieve all the change that is required. As a bank, and as an industry, we need to listen, learn and respond with actions. It is critical that our internal reforms are searching, mature and calibrated to contribute to the building of a better system. Again, we have tried to keep these considerations 'top of mind' in preparing the response which follows.

The first step in any reform is to understand the underlying causes of the issues which make that reform necessary. In my view there are at least four significant and inter-related changes that have happened which help to explain why things have gone wrong:

- *First*, there has been a shift in the way we view our customers and our role, leaving our industry open to your challenge that we have put "profits before people". We have failed to recognise that, ultimately, the interests of our shareholders are aligned with those of our customers in the sense that, if we get the customer experience right – if we serve our customers' interests well – we will build a sustainable business for all stakeholders.

- *Secondly*, banks, including NAB, have moved over time from taking a long-term view to a short-term one. This perspective has skewed the focus to nearer term outcomes at an institutional level (for example, profitability). Given the nature of our business and the risks associated with it, we need to refocus our planning over the five to ten year horizon, not just one to two years.
- *Thirdly*, there has been a shift from a time when the majority of people in the sector were remunerated with fixed pay. This led to most people receiving variable rewards, calculated by reference to short-term considerations including sales, growth and profits. NAB has made changes in this area over the last 12 months, and we are continuing to re-examine it and challenge ourselves to improve even further.
- *Finally*, banks have become more complex, in part due to increasing regulation, compliance obligations and legacy systems. It has also meant our bankers have in many cases lost the deep local connections they had with customers and the communities they serve.

These are issues that NAB has been considering for some time and which reflect our submissions on key questions raised by you in your interim report. For example:

- We have changed our assessment of performance by reforming performance plans for almost all employees. These emphasise the importance of longer term qualitative customer-centric metrics. Financial outcomes are now a minority component in that assessment (see paragraph 176 below).
- We have recently revised our deferred remuneration scheme for executives in a way which exceeds the requirements of the BEAR regime, so as to reward sustained performance and reorient the remuneration framework to longer term outcomes (see paragraph 183 below).
- We have committed to reform for mortgage brokers as soon as feasibly possible (and by 2020) to ensure that they are bound by a positively framed 'customer first duty'. This will require them to actively engage with customers to make a meaningful assessment of their circumstances and requirements, and to ensure that customers only obtain loans from NAB that they can afford and need (see paragraphs 189 to 198 below).
- We are actively working to simplify our internal policies and processes to ensure that they are better understood, easier to apply and calculated to produce better compliance and customer outcomes (see paragraph 166 below). This is an area of substantial effort and focus.
- We support the cessation of grandfathered commissions as well as the introduction of additional measures which encourage the transition of financial advice businesses to non-conflicted revenue models, including the repeal of the conflicted remuneration grandfathering provisions set out in the Corporations Act (see paragraphs 28 to 32 below).
- We have determined that default interest should not be charged to customers impacted by drought or other natural disasters; or beyond 12 months from when a loan becomes impaired. We will amend our credit contracts to formally embody this policy and are in the process of determining how best to ensure existing customers receive the benefit of this change. NAB has also committed to meet with customers, face-to-face, within 30 days of their agricultural loan becoming 90 days' past due (see paragraph 129 below).
- We have implemented a moratorium on branch closures in regions of Australia where there is a drought declaration in place. This affects 130 of NAB's branches and recognises the need to support customers and communities in these difficult times.
- We have also established a Centre for Customer Remediation, to ensure we compensate customers faster when we get things wrong. This is a specialist team that will focus on a consistent, fair and holistic approach to remediation.

In order for Australia to be ready for both the risks and opportunities we face in the future, we need banks that are strong. The financial system plays a key role in the Australian economy. It drives growth and raises living standards by channelling capital from diverse sources to businesses, consumers and the community. Well-capitalised and profitable financial institutions, together with a comprehensive regulatory framework, have supported Australia's continued economic growth for over 25 years, despite several significant external shocks. It is critical that this continues.

But strength is more than just about balance sheet or profitability – it is also about being valued by customers for the products and services we provide. This leads to trust. The process of earning that trust and confidence in our industry has started and we are taking action. There is much more work to do and it will take time to address the many issues identified by you.

We will take further actions to earn the trust and confidence of customers, shareholders and the community.

Yours sincerely



Andrew Thorburn

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INTRODUCTION

- 1 This submission is made on behalf of National Australia Bank Group (**NAB**) in response to the Commission's invitation to respond to the policy issues identified in the Interim Report.
- 2 The Australian financial system has undergone a significant number of inquiries and reviews in recent years. A number of reforms have been implemented in light of the findings arising out of these processes, and will continue to be delivered in the future. Noting the broad range of issues raised in the Interim Report, it is likely that there will be further reforms following the conclusion of the Commission. NAB believes that any reforms or policy recommendations would need to be considered cohesively and take account of reforms already underway or recently implemented.
- 3 The provision of banking services and affordable, quality financial advice are of critical importance to all Australians. Any future reforms aimed at improving customer outcomes and addressing misconduct should necessarily lead to a more stable and sustainable financial sector. In this regard, we note that the focus of reforms has been, and should continue to be, on ensuring the Australian financial system is competitive, resilient and well regulated. These are factors critical to both Australia's ongoing economic stability and growth, and ensuring good customer outcomes.
- 4 NAB observes that a number of recent reforms – yet to be implemented – have focused on competition, transparency and the promotion of improved customer outcomes. Reforms such as the incoming Open Banking regime and Design and Distribution Obligations recognise the importance of providing customers with adequate information and rebalancing the responsibility of industry participants to ensure that customers receive products, services and advice suited to their particular circumstances and needs. NAB is committed to ensuring that this continues to happen.

NAB's approach to this submission

- 5 Having regard to the Commission's request that submissions should be no longer than 50 pages, NAB has not responded to all of the questions raised in the Interim Report. Instead, NAB has responded to questions where NAB believes that it could add value to the further consideration and deliberation of certain issues by both the Commission and the public. NAB notes that it has previously made submissions on certain of the policy issues raised in the Interim Report in its submissions in the general questions arising from the first to fourth round of hearings of the Commission.

CONSUMER LENDING

Are ‘introducer’ programs compatible with responsible lending obligations?¹

- 6 Broadly, introducers refer a potential customer to the lender. Under NAB’s Introducer Program, an introducer may (but will not always) receive a ‘spot and refer’ fee for doing so. A referrer (or introducer) is not required to hold a credit licence, due to the exemption in regulation 25(5) of the *National Consumer Credit Protection Regulations 2010* (Cth).
- 7 As outlined in NAB’s submissions on the Introducer Case Study in the first round of hearings of the Commission,² NAB accepts there were previously weaknesses in our Introducer Program and has taken steps to address those weaknesses by making significant changes. NAB has improved its Introducer Program to ensure misconduct of the nature examined during the first round of hearings of the Commission hearings does not recur and that its introducers only operate within the regulatory exemption. This program is subject to ongoing review to ensure controls are appropriate and effective.
- 8 Accordingly, we believe that NAB’s Introducer Program in its current form is compatible with responsible lending obligations. Importantly, introducers are not involved in or authorised to gather information necessary for the verification, approval or provision of credit. It is the bank, as lender, that must undertake all responsible lending obligations and ensure that any introduction is made within the confines of the exemption.

Should the HEM continue to be used as a benchmark for borrowers’ living expenses?³

- 9 The Household Expenditure Measure (**HEM**) should continue to be used as a benchmark for borrowers’ living expenses. The HEM benchmark encourages a more detailed conversation about a borrower’s expenses. Where a borrower’s expenses are below the appropriate HEM benchmark for that customer, the HEM benchmark is used for the purposes of assessing loan unsuitability. In that manner, the HEM serves as a safety net by applying a minimum acceptable level of expenses. It is never used as a substitute for a comprehensive conversation or accurate information about a borrower’s position.
- 10 The HEM has been independently and academically researched. It is based on comprehensive expense information provided by the ABS. It is routinely reviewed and updated by the Melbourne Institute, a research institution at the University of Melbourne. NAB updates the tables used in the serviceability assessment to reflect these revised tables on at least an annual basis.
- 11 NAB has continually reviewed our approach to the use of HEM since first implementing the tables in 2012, and has made changes to that approach, as appropriate. Examples of these

¹ Interim Report, Volume 1 at pp 71, 328.

² NAB’s Submission to the Introducer Case Study in the first round of hearings of the Commission, at Sections B to D.

³ Interim Report, Volume 1, pp 71, 329.

changes include the introduction of message codes to front line staff in 2013 to alert them when a customer's declared expenses were lower than the HEM, and the move to an income indexed version of the HEM in 2015. The current version of the HEM tables used by NAB are adjusted by income level, by whether customers are single or in a relationship, and by the number of dependants.

- 12 In August 2018, the Melbourne Institute reissued data underpinning the HEM benchmark based on the latest survey conducted by the ABS. As such, NAB will implement updated HEM tables to reflect this information and to make the measure more robust in December 2018.
- 13 NAB continues to support discussions with industry regulators on the appropriate calibration of the measure to ensure it remains a comprehensive and reasonable benchmark.

FINANCIAL ADVICE

Managing conflicts

*Can conflicts of interest and duty be managed?*⁴

- 14 In NAB's view, conflicts of interest and duty are capable of being managed. NAB recognises the challenges that have been raised to the capacity of financial services institutions to manage conflicts, that managing conflicts is complex and needs rigorous attention to detail, and that we may not have got it right in the past. The importance of managing conflicts appropriately is balanced by the wide range of benefits to customers of vertically integrated structures – a matter NAB returns to below. NAB believes that the following points are important to consider as part of this review.
- 15 NAB does not believe there is an insurmountable conflict between customers' interests and "the adviser's interest ... to further his or her career and to maximise financial reward and the licensee's interest ... to maximise profit."⁵ In NAB's view, it is consistent with the longer-term objectives of licensees or advisers to consider and act in the interests of the customer: as in many industries, building a sustainable and profitable business requires honourable service to clients in a trustworthy and consistent manner.
- 16 There have been breakdowns in the policies and procedures in place to address conflicts and the management of conflicts of interest across the financial advice industry has been historically inadequate. However, it is important to note that many of the events identified by the Royal Commission concern products and advice which pre-date the Future of Financial Advice (FOFA) reforms. Those reforms commenced in 2012 and became mandatory from 1 July 2013.

⁴ Interim Report, Volume 1, pp 156, 330.

⁵ Interim Report, Volume 1, p 89.

- 17 The FOFA reforms provide a stronger legislative framework for managing conflicts of interest in relation to the provision of financial advice, in particular through the requirements for financial advisers providing personal advice to:
- (a) Act in the best interests of the client;
 - (b) To provide the client with appropriate advice; and
 - (c) To give priority to the client's interests. While the lessons from the Royal Commission show that the FOFA reforms were not a complete solution to the risks caused by conflicts of interest and duty, many of the instances of misconduct concerned arrangements which have been, or are being, phased out.
- 18 Industry-wide changes have been, and continue to be, implemented which will substantially strengthen conflicts management frameworks. Guidance from regulators, such as that provided in ASIC Reports 515 and 562, has been helpful in clarifying regulatory obligations, and NAB welcomes further guidance of a similar nature. Strengthening of the effectiveness of the FOFA reforms will be achieved by the *Corporations Amendment (Professional Standards of Financial Advisers) Act 2017* (Cth). This legislation is designed to introduce greater professionalism and a code of ethics for the industry. NAB welcomes this legislative reform.
- 19 NAB also believes that participants in the financial services industry are able to respond to deficiencies in the management of conflicts of interest and duty by strengthening their applicable internal policies and processes. Such a response is consistent with Australian Financial Service Licence holders' obligations to have in place adequate arrangements for the management of conflicts of interest.⁶ International practice also recognises that conflicts of interest within the financial advice industry are able to be managed through appropriate arrangements. The requirement in s 912A(1)(aa) of the *Corporations Act 2001* (Cth) (**Corporations Act**) that financial services entities have adequate arrangements to manage conflicts of interest (rather than eliminate them entirely) has parallels in other jurisdictions, for example the UK, the EU, Hong Kong and the US.⁷ To conclude that conflicts of interest cannot be managed in the Australian financial advice industry would make an exception which, in NAB's submission, is not warranted by this overseas experience.
- 20 The industry's ability to respond is reflective of NAB's own recent experience, in that, over the last 18 months, NAB has undertaken – and continues to undertake – substantial work to strengthen its policies and processes. Since late 2017 and throughout 2018, a key area of focus for NAB has been the design and continued uplift of key advice controls relating to best interest obligations, conflicted remuneration, adviser service fees, fee disclosure statements

⁶ Corporations Act, s 912A(1)(aa).

⁷ See, for example, UK: Principle 8 of the Financial Conduct Authority's (**FCA**) Principles for Businesses, FCA Handbook SYSC 10, FCA Handbook COBS 6; EU: Article 16(3) and 22 of Directive 2014/65/EU (MiFID II); Hong Kong: Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission, GP6; US: FINRA Manual, Rule 2241.

and opt-in to ongoing service agreements. In early 2018, NAB engaged external consultants to review the design effectiveness of these controls and supporting policies and procedures, and will implement improvements suggested by that review. This includes:

- (a) Revising key policies relating to adviser conduct and monitoring and supervision, which, among other things, impose obligations on financial advisers and are all designed to ensure advisers act in their clients' best interests and conduct all dealings with clients in an honest, efficient, and fair manner;⁸
- (b) Introducing enhanced audit frameworks including greater emphasis on compliance with the best interests duty and regular themed reviews of advisers based on high-risk areas or topics of concern;⁹
- (c) Broadening the number of external product manufacturers on NAB licensee platform and insurance provider approved product lists; and
- (d) Retaining an Independent Customer Advocate, who has been engaged across the advice business, providing critical client insights and perspectives across many aspects of the business.¹⁰

21 In implementing these internal changes, NAB has recognised that the proper management of conflicts of interest requires more than a directive to licensees and advisers that they follow the law: "adequate arrangements [to manage conflicts] require more than a raft of written policies and procedures. They require a thorough understanding of the procedures by all employees and a willingness and ability to apply them to a host of possible conflicts." In particular, the management of conflicts of interest and duty in the financial advice sphere requires a number of elements to create a compliant culture, including:

- (a) Remuneration that is structured in a way that rewards advisers giving priority to customer's interests (for example, by being based on the complexity of the client's needs);
- (b) Education and monitoring of employees and associates through robust and regular audit and assessment processes; and
- (c) Consequences to be applied where policies or processes to manage conflicts are breached.

22 The internal changes outlined above reflect NAB's commitment to ensuring that its processes and control environment are of a standard that meets community and regulatory expectations.

⁸ Exhibit 2.179, Witness statement of Andrew Hagger, 13 April 2018, [43] ff.

⁹ Exhibit 2.179, Witness statement of Andrew Hagger, 13 April 2018, [62]-[80].

¹⁰ Exhibit 2.179, Witness statement of Andrew Hagger, 13 April 2018, [101].

- 23 NAB is also open to working with government regulators and industry to further increase openness and transparency in the management of conflicts in the financial services industry. Some examples that NAB is willing to explore with industry include publishing approved product lists of all its licensees, and making available to clients our employed adviser remuneration structures.

Should an authorised representative be permitted to recommend a financial product manufactured or sold by the advice licensee (or a related entity of the licensee) with which the representative is associated? At all? Only on written demonstration that the product is better for the client than comparable third party products?¹¹

- 24 NAB considers that authorised representatives should continue to be permitted to recommend financial products manufactured or sold by the advice licensee (or a related entity of the licensee) with which the representative is associated.
- 25 However, NAB acknowledges that safe-guards are required to ensure that any products recommended are of an equal standard to third-party products. Those safe-guards can be implemented by the industry. For example, NAB's 'Licensee Standard – Best Interests Obligations' policy sets out processes and controls to ensure that where a product manufactured by a NAB Group entity is recommended, it must be better for the client than the client's existing product and at least comparable to similar alternative products in the market, such as the one selected for comparison (the **Conflicts Priority Rule**). A detailed written comparison with alternative products including a non-group product must be made and recorded in writing. NAB believes that the controls established by the Licensee Standard are appropriate.

How does a financial adviser's employer encourage provision of sound advice (including, where appropriate, telling the client to do nothing)?¹²

- 26 NAB believes that a financial adviser's employer encourages the provision of sound advice to clients by developing and promoting a genuinely client-centric culture in which advisers prioritise clients' interests.
- 27 NAB considers the following pillars to be central to developing a client-centric culture that encourages the provision of sound advice, and has implemented the identified key initiatives:¹³
- (a) *Professional standards:* Employers need to determine the minimum education and professional standards applicable to advisers. NAB has lifted the education and qualification standards for financial advisers by transitioning its advisers to holding

¹¹ Interim Report, Volume 1, pp 156, 331.

¹² Interim Report, Volume 1, pp 156, 330.

¹³ A more detailed list of initiatives can be found in paragraph 48 of NAB's submission in response to questions raised by Counsel Assisting in the second round of hearings of the Commission.

qualifications beyond current legislative requirements and memberships with Licensee-approved professional associations. Additionally, NAB continues to lift advisers' capability through its Continuing Professional Development program, one-on-one coaching sessions, peer forums, Professional Development days and conferences.

- (b) *Remuneration model:* Employers need to ensure that remuneration models encourage the provision of quality advice. Remuneration and incentives for financial advisers employed by NAB are dependent upon a range of factors (reflected in a 'balanced scorecard' approach, with less than 35% based on financial incentives). Those factors include the extent to which advisers have demonstrated customer-centric behaviours, undertaken proactive risk management and compliance and acted in accordance with NAB's values.
- (c) *Reward and recognition programs:* An employer's reward and recognition programs should celebrate and encourage the provision of quality advice. NAB Financial Planning (**NAB FP**) has introduced Quality Advice Awards which recognise positive client outcomes with no financial benefit to the adviser.
- (d) *Policies and procedures:* Employers should have in place policies and procedures that put the clients' interests ahead of advisers' and their own. For example, NAB's Licensee Standards encourage advisers to tell customers to do nothing, where appropriate. NAB's 'Licensee Standard – Best Interests Obligations' requires that an advice document demonstrate that advice is likely to leave the client better off, financially or in other relevant respects. A stated example of where that requirement is met is that the adviser confirms that no change is required, as existing arrangements are appropriate for the client.
- (e) *Adviser recruitment:* Employers need to be sensitive about their recruitment culture to ensure that future employees are aligned with their values. NAB FP has a stringent recruitment process which includes a technical assessment and a detailed compliance overlay for experienced financial advisers.
- (f) *Conduct and consequence management:* Employers need to have a considered approach to addressing conduct issues which takes account of the cultural implications of consequence management. For example, NAB identified the issue of the false witnessing of beneficiary nomination forms and applied consequence outcomes across NAB FP in 2017, including to its management team, setting a clear expectation of acceptable behaviour and professionalism.

Remuneration and incentives

Should the grandfathered exceptions to the conflicted remuneration provisions now be changed?

- ***How far should they be changed?***
 - ***If they should be changed, when should the change or changes take effect?*¹⁴**
- 28 NAB supports the cessation of grandfathered commissions and further supports measures which encourage the transition of financial advice businesses to non-conflicted revenue models. In particular, NAB supports the repeal of the conflicted remuneration grandfathering provisions set out in ss 1528, 1529 and 1531 of the Corporations Act.
- 29 At the time the FOFA reforms were introduced, grandfathered commissions were intended to be a transitional arrangement. NAB acknowledges that, in retrospect, the 'grandfathering' provisions would have benefited from sun-setting conditions.
- 30 Any legislation to repeal the conflicted remuneration grandfathering provisions should:
- (a) Capture all types of grandfathered conflicted remuneration;
 - (b) Proceed on the basis that the benefits of the changes for grandfathered commissions are to be passed onto customers; and
 - (c) Set a reasonable implementation period.¹⁵
- 31 A legislated approach will provide a more efficient approach to implementation and consistent benefits for consumers.
- 32 As has already been announced, NAB FP will no longer accept grandfathered commissions from NAB Wealth superannuation and investment product providers, with effect from 1 January 2019.

Should the life risk exceptions to the conflicted remuneration provisions now be changed?

- ***How far should they be changed?***
 - ***If they should be changed, when should the change or changes take effect?*¹⁶**
- 33 Reforms have been commenced in the life insurance industry in the last 12 months and are to take effect in stages through until 2020.¹⁷ Those reforms have sought to better align the interests of insurers, advisers and customers.

¹⁴ Interim Report, Volume 1, pp 157, 331.

¹⁵ NAB General submissions in response to the second round of hearings of the Commission, [15] – [16].

¹⁶ Interim Report, Volume 1, pp 157, 331.

¹⁷ *Corporations Amendment (Life Insurance Remuneration Arrangements) Act 2017*; ASIC Regulatory Guidance (CP245), Life Insurance Code of Practice and Approved Product List Industry Standard.

- 34 The reforms include phasing down upfront commissions and the introduction of a retention ('clawback') period. They improve the alignment of the interests of insurers and advisers with those of customers and recognise the need for a phased transition to ensure that advisers have time to adjust their business models to comply with the reforms.
- 35 NAB supports the intent of those changes, and notes they have recently been reviewed comprehensively by Parliament which has had to weigh the risk of underinsurance with the need to reduce the risk of other adverse client outcomes.¹⁸
- 36 In these circumstances, NAB's position is that the industry ought be given the originally set time to implement the reforms. Further, ASIC's post-implementation review of the reforms will assist in answering the question of whether the life risk carve-out from the conflicted remuneration provisions ought be maintained.¹⁹

***Should any part of the remuneration of financial advisors be dependent on value or volume of sales?*²⁰**

- 37 In principle, subject to the matters discussed at paragraphs 30 to 36 above in respect of life risk, and to similar general insurance exemptions,²¹ NAB supports an industry transition away from the remuneration of financial advisers being dependent on the value or volume of product sales (as distinct from advice fee revenue).

***Are current product and interests disclosure requirements sufficient to allow customers to make fully informed choices?*²²**

- 38 In NAB's view, current product and interests disclosure requirements are extensive and require disclosure of sufficient information to allow clients to make fully informed choices. We believe this complexity makes it extremely difficult for a client to have truly understood the disclosure. Therein, NAB supports consideration of regulatory guidance to facilitate simpler and shorter product disclosure, in light of the manner in which customers use disclosure documents.
- 39 The information required to be disclosed under the present product disclosure regime includes the numerous matters set out in s 1013D of the Corporations Act. Disclosure must also be given of all information that might reasonably be expected to have a material influence on the decision of a reasonable person, as a retail client, whether to acquire a relevant product.²³ Consequently, disclosure is often voluminous. This complexity is compounded by the differing

¹⁸ Chapter 5, Report of the Parliamentary Joint Committee on Corporations and Financial Services – Life Insurance Industry, March 2018.

¹⁹ ASIC Media Release, 17-168MR ASIC releases instrument setting the commission caps and clawback amounts as part of the life insurance advice reforms, 5 June 2017.

²⁰ Interim Report, Volume 1, pp 157, 331.

²¹ See NAB's submission in response to question 7 of the policy questions arising from the sixth round of hearings of the Commission on insurance, in respect of NAB's position on the general insurance exemptions to conflicted remuneration.

²² Interim Report, Volume 1, pp 157, 332.

²³ Section 1013E of the Corporations Act.

disclosure requirements for personal advice, intrafund advice and products. Despite attempts over the past two decades to reform disclosure requirements through legislation and regulatory intervention, in NAB's view customers continue to face challenges due to the complexity and volume of disclosure. The most frequently cited problem with mandated disclosure documents is their length and complexity, which may result in many customers not reading or understanding them.²⁴

- 40 On the other hand, information contained in product disclosure statements is also required to be worded and presented in a "clear, concise and effective manner".²⁵ Voluminous disclosure material runs the risk of not satisfying this objective.
- 41 In light of these matters, NAB supports regulatory guidance and industry focus on how best to reconcile the need for the clear, concise and effective presentation of information with the large amount of mandatory information required to be included in product disclosure statements.
- 42 Importantly, in NAB's view, disclosure requirements are not a complete means of ensuring that customers are able to make fully informed choices. Disclosure must be supplemented by sound advice, supported by the training and monitoring of advisers with regard to best interests obligations. NAB has taken measures to ensure that the training and monitoring of advisers is robust, as described at paragraphs 20 and 27 above.

Business structures

Do the events that have happened raise any issue about business structures?²⁶

How far can, and how far should, there be separation between providing financial advice and manufacture or sale of financial products?²⁷

- 43 NAB believes that clients do benefit from a properly managed vertically integrated model of platform operators and advice licensees. As noted by ASIC:

Vertical integration can provide economies of scale and other benefits for both the financial institution and its customers. The economies of scale may allow customers to access advice at lower cost. Customers may choose to obtain both advice and financial products from a vertically integrated institution because of the convenience of a relationship with a single financial institution. They may also value the perceived safety of dealing with a large institution, and have trust and

²⁴ Transcript, Robert Whelan of Insurance Council of Australia, 21 September 2018, 6421:23-24; Insurance Council of Australia, 'Too Long; Didn't Read: Enhancing General Insurance Disclosure – Report of the Effective Disclosure Taskforce to Insurance Council Board', October 2015 at pp 17, 27, 29.

²⁵ Corporations Act, s 1013C(3).

²⁶ Interim Report, Volume 1, pp 323, 326, 342.

²⁷ Interim Report, Volume 1, pp 156, 330.

*confidence in the ability of the institution to both deliver the services and compensate them appropriately if required.*²⁸

- 44 The benefits of large vertically-integrated wealth businesses include:
- (a) The ability to pass on scale benefits to customers, such as rebates on asset management products (including both in-house and externally manufactured products);
 - (b) Close linkage between feedback from advice clients and product design; sophisticated infrastructure, such as calculators and tools supporting advice outcomes (including tax and similar complex regulatory provisions which can change frequently);
 - (c) Well-developed and resourced monitoring and supervision of advisers, which have the potential to be more robust and cost-effective in these structures; and
 - (d) The financial capacity to appropriately fund customer remediation, when required.
- 45 An enforced separation would likely lead to the removal of these benefits and increase the costs of provision of products and services to clients, including advice.
- 46 NAB recognises the potential, in vertically integrated wealth businesses, for remuneration structures to be conflicted and for the overselling of 'in-house' products. However, NAB believes that these risks can be adequately managed through conflicts management controls, policies and processes that are client-focussed, known, understood, and enforced. With this in mind, as outlined at paragraphs 20 and following, NAB is enhancing and refining its conflicts management controls, policies and processes.
- 47 NAB also notes that many businesses within the financial services sector are vertically integrated, including many industry funds and some self-licensed advice businesses. As such, the impact of any enforced separation should not be under-estimated. Disaggregating the manufacture or sale of financial products, on the one hand, and financial advice, on the other, would be a radical change affecting businesses of all sizes, and many individuals, across Australia.

SMALL AND MEDIUM ENTERPRISES

Should there be any change to the legal framework governing small and medium enterprise (SME) lending?²⁹

- 48 Particularly given 97% of all business are small businesses, the contribution of SMEs to the Australian economy is vital, and the supply of credit to that sector is correspondingly critical.³⁰

²⁸ ASIC Report 562, *Financial Advice: vertically integrated institutions and conflicts of interest*, paragraph 8, p3.

²⁹ Interim Report, Volume 1, pp 182, 333.

In NAB's view, it is most important that any changes in the area of lending to SMEs balances the need to ensure the ongoing supply of credit.³¹ Lending to SMEs requires consideration and understanding of various and in some cases, complex, business structures.

- 49 NAB considers that the current legal framework is sound and when properly applied ensures that banks are able to lend responsibly, while also accommodating the varied business structures and lending needs of SMEs. Accordingly NAB considers that the legal framework for SME lending should not change.
- 50 NAB is concerned that any changes to the framework could result in unintended consequences, seeing some customers unable to obtain credit and potentially stifling entrepreneurship and innovation both for SMEs and the broader economy. A more prescriptive (or less flexible) framework may:
- (a) Require customers to satisfy a pre-determined set of criteria that cannot be applied to their particular circumstances. Failure to do so may result in some customers being unable to obtain credit; and
 - (b) Affect innovation and competition amongst lenders to SMEs. Continued technological progress will create efficiencies in the current credit modeling and assessment process, with corresponding benefits to SME customers. The benefits arising from those technological advancements may not be realised if there is a shift towards a more prescriptive approach, which cannot readily adapt to technological advancements.

Should any lending to SMEs come within the reach of the National Consumer Credit Protection Act 2009 (Cth) (the NCCP Act)?³²

- 51 NAB does not support extending the application of any of the *National Consumer Credit Protection Act 2009 (Cth) (NCCP Act)*³³ provisions to SMEs.³⁴
- 52 The NCCP Act places greater emphasis on using past earnings as a means to assess servicing, whereas credit assessments for SME customers are based upon future forecast earnings. Those measures may not always be applicable to an SME customer. For example, the relevant consumer credit standards in the NCCP Act could not be implemented to cashflow forecasting for SME customers, particularly if the forecasts relate to ventures that are newly established or remain speculative because certain events are yet to happen.

³⁰ As referred to in the Opening Submissions of Counsel Assisting, third round of hearings of the Commission, 21 May 2018, T1993:40; Australian Small Business and Family Enterprise Ombudsman, *Small Business Counts, Small Business in the Australian Economy*, 2016, p 8.

³¹ As referred to in the Opening Submissions of Counsel Assisting, third round of hearings of the Commission, 21 May 2018, T1992:42-45; T1997:25 ff.

³² Interim Report, Volume 1, pp 182, 333.

³³ This includes the National Credit Code which appears at Schedule 1 to the NCCP Act.

³⁴ NAB written submission, third round of hearings of the Commission: Loans to Small and Medium Enterprises, 12 June 2018, [16] to [17].

- 53 If the emphasis on past performance is extended to SME customers, NAB considers that it could potentially lead to significant harmful repercussions for customers and the broader Australian economy, as some SME customers may not be able to obtain credit. This may occur if a rigid and uniform approach was required in assessing all SME customers.

What inquiries should a diligent and prudent banker make when deciding whether to lend to an SME?³⁵

Does ‘forming an opinion about the customer’s ability to repay the loan facility’ as required by Clause 51 of the 2019 Code involve bringing critical analysis to the cash flow forecasts and other business plan documents presented by customers?³⁶

If so, what level of analysis is acceptable?³⁷

Is it enough that the lender satisfy itself the borrower can repay the loan and that the business plan is not obviously flawed?³⁸

Is the standard set out in Clause 51 of the 2019 Code, which requires a bank to determine whether a customer can repay a loan based on their financial position and account conduct, a sufficient standard?³⁹

- 54 NAB considers that the enquiries in the Banking Code of Practice (**the Code**) which are required to comply with the obligation to act with the care and skill of a diligent and prudent banker in its current form (and in the 2019 Banking Code of Practice (**the 2019 Code**), referred to below) provide the necessary flexibility to accommodate a wide range of customer circumstances and allow the lender to be appropriately satisfied that the customer can repay the loan.
- 55 That is, and should remain, the core enquiry in the area of small business lending because small business customers are diverse and require a broad range of flexible lending solutions and services. The enquiries and risk involved in lending to a well-established customer will be very different to that of lending to a customer establishing a new business. This requires a case-specific assessment of the nature of the borrower’s business, or proposed business and borrowing needs.
- 56 In the context of making the capacity to repay assessment and in carrying out the obligation of a diligent and prudent banker, NAB seeks information and undertakes a number of assessments described below. As SME lending involves an assessment of a businesses’ ability to raise cash flow, increase productivity or preserve value in the future, an analysis of forecast financials and the risk that those forecasts will not be met (which may result in an inability to repay the loan) is required. These assessments and the associated variables and risks have an inherent element of uncertainty, and are an important point of differentiation from the credit decision involved in consumer lending where the assessment is more focused

³⁵ Interim Report, Volume 1, pp 183, 334.

³⁶ Interim Report, Volume 1, pp 183, 334.

³⁷ Interim Report, Volume 1, pp 183, 334.

³⁸ Interim Report, Volume 1, pp 183, 334.

³⁹ Interim Report, Volume 1, pp 183, 334.

on historic financial information. As such, NAB does not consider that the role of the lender should – or, realistically, could – extend to providing a critical analysis of cash flow forecasts and other business plan documents, nor should it require a lender to go beyond making an assessment that the business plan is ‘not obviously flawed’.

The diligent and prudent banker

57 NAB and other small business lenders are bound by the obligations under Clause 27 of the the Code to act as a diligent and prudent banker.⁴⁰ Whilst expressed differently, the concepts in Clause 27 are replicated in Clause 51 of the 2019 Code which states:

If you are a small business, when assessing whether you can repay the loan we will do so by considering the appropriate circumstances reasonably known to us about:

- a) your financial position; or*
- b) your account conduct.*

Where reasonable to do so, we may rely on the resources of third parties available to you, provided that the third party has a connection to you (that is, to the small business). For example where the third party is a related entity of yours (including but not limited to your directors, shareholders, trustees, beneficiaries or related body corporates), or is a partner, joint venturer, or guarantor of yours.⁴¹

58 For the reasons outlined below, NAB considers that the standard set out in Clause 51 of the 2019 Code is a sufficient and appropriate standard.

59 The Code sets, and the 2019 Code will set, the standards regarding how a bank assesses and forms an opinion of a customer’s ability to repay a loan. This obligation – to act as a prudent and diligent banker – provides protection for customers (including guarantors)⁴² by ensuring that due care and skill are exercised in deciding whether to offer customers facilities thereby reducing the future risk that loans will go into default.⁴³

60 In fulfilling its commitment to act with the care and skill of a diligent and prudent banker, NAB makes enquiries to seek detailed information and documents from its customers so its understanding of the customer’s business is appropriate when assessing credit. This includes:

- (a) Whether the loan is for business purposes;
- (b) Assessing the customer’s financial information, including assumptions relating to future cash flows and the adequacy of debt servicing capacities; and

⁴⁰ NAB written submission, third round of hearings of the Commission: Loans to Small and Medium Enterprises, 12 June 2018, [12].

⁴¹ ABA Banking Code of Practice 2019, Clause 51, p 25.

⁴² ABA Banking Code of Practice 2019, Clause 52, p 25.

⁴³ NAB written submission, third round of hearings of the Commission: Loans to Small and Medium Enterprises, 12 June 2018, [12].

- (c) Other relevant information, for example the credit history of the customer and whether any security is available.

61 As part of the credit assessment process, NAB may also request a copy of the customer's business plan. When assessing a business plan, NAB does not assess its viability beyond making an assessment that it is 'not obviously flawed', because NAB considers that the customer is best placed (including through the use of their own independent legal and financial advisors) to make this commercial and strategic assessment to be satisfied that its business is viable. NAB is concerned that any additional obligation on a lender may lead a customer to believe that the decision to provide credit constitutes advice regarding the viability or strategic direction of the business.

62 NAB adopts a holistic view in undertaking these enquiries by taking into account issues and risks such as:

- (a) *Customer / Management experience*: capacity and prior experience of the customer and the management (or advisory) team supporting the business;
- (b) *Contingency planning*: how well-equipped the customer is to face any business challenges such as expansion plans, economic downturns, changes in competition which may impact on future debt servicing;
- (c) *Industry insights*: the customer's industry, key industry drivers and players, the customer's position within the industry and industry cyclical factors; and
- (d) *Character*: whether the customer genuinely intends to repay the loan.

NAB believes this interpretation and application of the obligation properly accommodates the diversity and complexity of the needs of SME customers.

If established principles of judge-made law and statutory provisions about unconscionability would not relieve a guarantor of responsibility under a guarantee, and if, further, a bank's voluntary undertaking to a potential guarantor to exercise the care and skill of a diligent and prudent banker has not been breached, are there circumstances in which the law should nevertheless hold that the guarantee may not be enforced?⁴⁴

What would those circumstances be?⁴⁵

63 There are a number of established legal protections for guarantors, which are outlined in paragraphs 65 to 70 below. NAB considers that they offer sufficient and appropriate protection to guarantors. Accordingly, NAB does not consider the law needs to prescribe additional circumstances in which a guarantee would be unenforceable.

64 Whilst NAB does not consider that additional prescribed circumstances are necessary, it is important to note that NAB adopts a case by case approach to enforcement against

⁴⁴ Interim Report, Volume 1, pp 184, 334.

⁴⁵ Interim Report, Volume 1, pp 184, 334.

guarantors to determine whether enforcement is appropriate having regard to the individual circumstances. Where a customer is in default, NAB may elect not to enforce a guarantee, where it does not consider that it would be appropriate to do so, having regard to all of the circumstances and information available to NAB at that time. This is consistent with NAB's Strategic Business Services (**SBS**) Principles which recognises that successfully resolving financial difficulties is the best result for customers and the bank, which may require maximizing options.⁴⁶ However, NAB considers that seeking to be prescriptive about these circumstances is neither desirable nor necessary.

65 The established legal protections include the rules of equity, which provide protection for guarantors in cases where the procurement of a guarantee or its enforcement is unconscionable. This includes situations where:

- (a) A credit provider takes advantage of a guarantor's special disadvantage;⁴⁷ and
- (b) A credit provider is on notice of a relationship of trust and confidence between the guarantor and the principal borrower and fails to adequately explain the nature of the transaction to a guarantor.⁴⁸

66 Further, there are statutory protections available to guarantors, for example, in the *Australian Securities and Investments Commission Act 2001* (Cth) (**ASIC Act**) and the *Contracts Review Act 1980* (NSW) (**Contracts Review Act**). The ASIC Act prohibits unconscionable conduct within the meaning of the unwritten law and in connection with supply or acquisition of financial services.⁴⁹ The Contracts Review Act provides relief against "unjust" contracts or provisions.⁵⁰

67 Clause 31 of the Code and clause 96 of the 2019 Code also provide extensive protections for guarantors.⁵¹ For example, the Code requires signatory banks (which includes NAB) to give guarantors prominent notice that:

- (a) The guarantor should seek independent legal and financial advice on the effect of the guarantee (cl 31.4(a)(i) Code and cl 96(a) 2019 Code);

⁴⁶ NAB Strategic Business Services Principles, Exhibit 3.140.19. The Strategic Business Services Categorisation Form also sets out various factors and circumstances to be considered (NAB.005.251.0031).

⁴⁷ *Commercial Bank of Australia Ltd v Amadio* (1983) 151 CLR 447.

⁴⁸ *Garcia v National Australia Bank Ltd* (1998) 194 CLR 395. See also *Kranz v National Australia Bank Ltd* (2003) 8 VR 310.

⁴⁹ ASIC Act, ss 12CA, 12CB. Section 12CB is not limited by the unwritten law of the States and Territories relating to unconscionable conduct: s 12CB(4)(a). Further, in determining whether conduct is unconscionable within the meaning of s 12CB of the ASIC Act, the Court must have regard to a range of factors, including (*inter alia*) the terms of any applicable industry code, such as the Code: s 12CC(1)(h).

⁵⁰ "Unjust" includes contracts or provisions which are "unconscionable, harsh or oppressive": s 4(1). The criteria for determining whether a contract or provision is "unjust" are provided for in s 9(1). The protections have been successfully invoked by guarantors: see e.g. *Fast Fix Loans Pty Ltd v Samardzic* [2011] NSWCA 260.

⁵¹ *National Australia Bank v Rose* [2016] VSCA 169 established that these requirements form part of the contract and if breached, give rise to contractual remedies (including, where appropriate, rescission).

- (b) The guarantor can refuse to enter into the guarantee (cl 31.4(a)(ii) Code, cl 96(b) 2019 Code);
- (c) There are financial risks involved (cl 31.4(a)(iii) Code, cl 96(c) 2019 Code);
- (d) The guarantor has a right to limit their liability in accordance with the Code and as allowed by law (cl 31.4(a)(iv) Code, cl 96(d) 2019 Code); and
- (e) The guarantor can request information about the transaction or facility to be guaranteed (cl 31.4(a)(v) Code, cl 96(e) 2019 Code).

68 Clause 31 of the Code and clause 97 of the 2019 Code also require signatory banks to provide specific information to the guarantor about the borrower and the facility before taking a guarantee from the guarantor (cl 31.4(b) Code, cl 97 2019 Code).

69 In addition to the protections outlined above, the 2019 Code also enhances the existing protections (see Part 7 of the 2019 Code), by requiring at least 3 days (instead of 1 day) for the guarantor to consider information and seek advice should they wish to do so before providing a guarantee (cl 107 2019 Code).

70 The 2019 Code also provides (by Chapter 14, clauses 38 to 41)⁵² that the signatory banks are committed to taking extra care with all vulnerable customers and guarantors, including those experiencing age-related impairment, cognitive impairment, elder abuse, family or domestic violence, financial abuse, mental illness, serious illness, or any other personal, or financial, circumstance causing significant detriment.

Is there a reason to shift the boundaries of established principles, existing law and the industry code of conduct?⁵³

71 Having regard to the current legal framework outlined in paragraphs 48 to 50 above, NAB does not consider that there is any reason to shift the boundaries of established principles, existing law and the Code or 2019 Code because NAB does not consider there to be any inadequacy or gap in the legal protections available to guarantors that would warrant such a shift. While the Commission has exposed issues in the application of this legal framework, they do not imply that the framework itself is inadequate. In addition, the enhanced protections in the 2019 Code will mitigate against recurrence of any implementation issues.

⁵² Clause 38 refers to vulnerable “customers”, whereas clauses 39 to 41 use the language of “you” and “your”. By clause 1, these words are defined to include guarantors and prospective guarantors.

⁵³ Interim Report, Volume 1, pp 184, 335.

If the guarantor is a volunteer, and if further, the guarantor is aware of the nature and extent of the obligations undertaken by executing the guarantee, is there some additional requirement that must be shown to have been met before the guarantee was given if it is to be an enforceable undertaking?⁵⁴

72 NAB does not consider that any additional steps for the procurement of third-party guarantees should be required in circumstances where the legal framework outlined in paragraphs 48 to 50 above is applied by lenders. NAB considers that where the legal framework is complied with, there is no need for additional requirements that must be met by the guarantors (including volunteer guarantors).

73 NAB recognises that volunteer guarantors are often parents or spouses who are motivated by love and the desire to assist their loved one.⁵⁵ In those circumstances, introducing additional requirements (such as obtaining advice and providing additional information) may be unlikely to influence the prospective guarantor's decision-making. Imposing additional requirements assumes, incorrectly, that emotionally-driven decision-making will be influenced by additional advice or information. Accordingly, NAB does not consider that imposing additional requirements is the appropriate approach to take, nor is it necessary in circumstances where the current legal framework offers sufficient protection to guarantors.

74 However, NAB considers that if any additional requirements were to be imposed, those requirements should be directed to ensuring that the guarantor fully understands the nature and risks of the transaction and is entering into the guarantee freely.

Should lenders give potential guarantors more information about the borrower or the proposed loan? What information could be given with respect to a new business?⁵⁶

75 In NAB's view, the information that will be provided to guarantors pursuant to clauses 99 and 101 of the 2019 Code are sufficient for the purposes of providing the guarantor (and their legal and financial advisor(s)) with appropriate material both before the guarantee is entered into, or during the guarantee. With this in mind, NAB does not consider that banks should be required to provide potential guarantors with more information about the borrower or the proposed loan.

⁵⁴ Interim Report, Volume 1, pp 184, 335.

⁵⁵ Interim Report, Volume 1, pp 169, 178.

⁵⁶ Interim Report, Volume 1, pp 184, 335.

AFCA and FOS

Should AFCA adopt FOS's approach of putting the borrower back in the position they would be in if the loan had not been made, but not awarding compensation for losses or harm caused?⁵⁷

Are there circumstances in which AFCA should waive a customer's debt?⁵⁸

- 76 Under the Australian Financial Complaints Authority (**AFCA**) Rules, AFCA has some limited powers to award compensation for losses or harm caused. AFCA has the power to decide whether a bank should compensate a complainant for direct financial loss⁵⁹ and/or indirect financial loss.⁶⁰ There are certain exclusions and limitations on such compensation as set out in the AFCA Rules.⁶¹ Importantly, punitive, exemplary or aggravated damages cannot be awarded by AFCA.⁶² AFCA can also require a bank to contribute up to \$5000 in legal or other professional or travel costs of the complainant.⁶³
- 77 AFCA is also empowered to forgive or vary a debt, release security for debt and then reinstate, vary, rectify or set aside a contract.⁶⁴ This mirrors the broad and flexible remedies available to the Financial Ombudsman Service (**FOS**) under paragraph 9.2 of the FOS Terms of Reference. The remedies available to AFCA are appropriate and commensurate with its role as an external dispute resolution body.
- 78 NAB considers that the policy that AFCA adopts in its approach to remediating and compensating borrowers (including the circumstances in which it waives a customer's debt) is something that should be determined by AFCA. Given the varied business structures and lending arrangements of small business, it is important that AFCA's approach is congruent of this complexity and develops this approach in consultation with relevant stakeholders such as consumer groups, banks and industry.

AGRICULTURAL LENDING

How are borrowers and lenders in the agricultural sector to deal with the consequences of uncontrollable and unforeseen external events?⁶⁵

- 79 In addressing this question, NAB's focus is on how lenders in the agricultural sector are to deal with the consequences of uncontrollable and unforeseen external events. Lenders can deal with the consequences both through their:

⁵⁷ Interim Report, Volume 1, pp 184, 335.

⁵⁸ Interim Report, Volume 1, pp 184, 335.

⁵⁹ AFCA Rules, rule D.3.1.

⁶⁰ AFCA Rules, rule D.3.2.

⁶¹ AFCA Rules, rule D.4.

⁶² AFCA Rules, rule D.3.4.

⁶³ AFCA Rules, rule D.5.

⁶⁴ AFCA Rules, rules D.2.1 (b), (c), (e).

⁶⁵ Interim Report, Volume 1, pp 242, 255, 335.

- (a) Approach to lending to agricultural business and managing against the risk of those external events; and
- (b) Response to the external events once they occur.

Approach to lending and managing against the risk of external events

- 80 NAB's agribusiness bankers are experienced and have expertise in agricultural lending. NAB has a long standing graduate program for hiring agribusiness bankers, employing graduates with relevant agricultural degrees. NAB's agri segment also has a targeted training approach to ensure that bankers are equipped with the required specialised skills.
- 81 While operating any business carries the prospect of the need to deal with the consequences of uncontrollable and unforeseen external events, NAB acknowledges that agricultural customers experience greater volatility in earnings than many other customers, in part because of exposure to unforeseen events such as serious drought, floods or cyclones, but also because of more general seasonal and commodity price variations.
- 82 There are a range of approaches available to lenders in providing credit in the agricultural sector and in managing against the risk of external events. NAB's approach includes the following:
- (a) A longer credit assessment cycle is used for agricultural customers. NAB's approach is to look at business performance for a period of up ten years, as compared with three years for other business lending. This longer-term view allows for consideration to be given to the variability of seasonal conditions, commodity prices, currency fluctuations and overall industry outlook over that period. It also allows NAB to have a better understanding of what a genuine 'average' year might look like. This smooths the effects of exceptional years (for example, a year in which there was a record harvest for a crop business), which might otherwise lead to the over-provision of credit, which cannot be repaid upon the occurrence of a negative external shock.
 - (b) NAB combines historical data (over a 10 year period) with projected performance. This can help lenders make the best estimate of likely performance in an 'average' year, modified for known impacts. NAB refers to this as a Sustainable Year calculation. To assess the impact of a drop in income and an increase in costs, a sensitivity analysis can be run.
 - (c) NAB has also committed to embedding management of natural capital into credit risk assessment process, with the aim of ensuring natural capital risk becomes priced like other forms of risk as part of its Natural Value strategy. Natural capital is the earth's natural assets (biodiversity and ecosystems) and the ecosystem services resulting from them (e.g. soil, air and water). This recognises that responsible management of natural capital by agricultural customers can have a positive impact on their

performance by limiting the risk of loss materialising from negative external events. To that end, NAB's Natural Value strategy includes building awareness about the importance of natural capital in Australia, building employee capability within NAB's agribusiness team to understand natural capital risk and investing in research to provide insight for customers to aid them in managing their natural capital.⁶⁶

- (d) NAB periodically reviews and updates training of agribusiness bankers to ensure bankers have the right skills and understanding of the rural sector. This enables a deep understanding of NAB's agricultural customers and the events and challenges that the industry face.

83 In addition, the products themselves available to agricultural customers may assist in the management of unforeseen external shocks:

- (a) NAB's Farmers Choice Package provides loans with a longer tenure than those generally provided to other businesses. Principal and interest payments are also structured to take account of the fact that an agribusiness customer's cash flows are uneven.
- (b) NAB also offers various risk management tools such as commodity swap arrangements which provide the ability to fix a minimum price for commodities such as wheat and barley, and the fixing of interest rates for selected periods for all or portions of a loan.
- (c) As part of the Farm Management Deposits Scheme,⁶⁷ NAB offers a farm management deposit account, which is designed to provide a buffer against volatility unique to the agricultural sector.

Responding to external events

84 If an uncontrollable and unforeseen external event occurs, NAB can also offer a range of relief measures for affected customers.

85 Those relief measures may be offered by way of a formal relief package for all customers affected by a particular external event, as occurred in July 2018 when NAB announced its Drought Assistance Package to support customers enduring prolonged drought conditions across NSW and Queensland, which are now nationally available.

86 Alternatively, that relief may be provided on a bespoke basis for particular customers dealing with the impacts of an external event. In either case, the particular form of relief should be determined by reference to the customer's particular circumstance. The range of relief

⁶⁶ NAB Sustainability Report 2017 at p 61:

<https://www.nab.com.au/content/dam/nabrwd/documents/reports/corporate/sustainability-report-2017.pdf>

⁶⁷ See Interim Report, Volume 1, pp 227-228.

measures that NAB can offer to assist its customers to deal with the impact of the external event can include, depending on the customer's particular circumstances:

- (a) The provision of additional financial accommodation, such as extending an overdraft;
- (b) The provision of temporary relief, including by suspending or postponing repayments, relaxation or waiver of covenants, the deferral of amortisation or interest payment relief;
- (c) Extension of loan terms, restructure of loans, consideration of restructure of loan repayments to interest only and waiver of all associated extension or restructure fees;
- (d) Waiving costs and charges for early withdrawal of Term Deposits (including Farm Management Deposits);
- (e) Further capital injections into the business; or
- (f) Making available to customers, the support and counselling services usually provided to employees through NAB's Employee Assistance Program.

87 From NAB's perspective, one important step is for NAB and customers to engage early (as discussed at paragraphs 129 and 130, below), so that NAB can understand what form of relief could be provided. NAB recognises that engagement with agricultural customers and their advisors is important when customers face difficult financial circumstances and acknowledges the stress that they may face in dealing with NAB when financial difficulties arise.

***Does the 2019 Banking Code of Practice provide adequate protection for agricultural businesses? If not, what changes should be made?*⁶⁸**

88 NAB believes that the 2019 Code provides adequate protection for agricultural businesses.

89 In relation to the concern in the Interim Report that the reach of the 2019 Code in agricultural lending is diminished, due to a change in the definition of small business in the 2019 Code, NAB notes that approximately 93% (~26,000 out of ~28,000 customers) of NAB's agribusiness customers have aggregated business lending of less than \$3m, thereby falling within the small business definition of the 2019 Code.

90 Accordingly, these agricultural customers are afforded certain specific protections in the 2019 Code identified in the Interim Report such as longer minimum periods of notice concerning changing loan conditions, removal of material adverse change clauses and restriction of the operation of non-monetary default clauses. These changes strengthen the protection given to the overwhelming majority of NAB's agricultural customers and were developed in response to awareness (prior to the development of the 2019 Code) of precisely the same types of issues raised in the Commission.

⁶⁸ Interim Report, Volume 1, pp 255, 336.

- 91 In addition, the 2019 Code (like the current Code) contains a number of more general obligations on banks, which operate to protect the customer, including the 'diligent and prudent banker' test and the obligation to engage with customers in a fair, reasonable and ethical manner.
- 92 With regard to the diligent and prudent banker test, NAB notes that as is true for all SME customers, agricultural customers are diverse and require flexible lending solutions and services. Accordingly, NAB reiterates its comments at paragraphs 55, 56 and 62 above, noting that the obligation calls for a holistic view of customer issues and risks, and that this approach accommodates the diversity and complexity of the SME sector (including agricultural customers).
- 93 In respect of the obligation of banks to engage with customers in a fair, reasonable and ethical manner (formerly clause 3.2 of the 2013 Code), as NAB has previously submitted to the Commission, judicial guidance states that fulfilment of the obligation requires consideration of all the relevant facts and circumstances of the customer and the conduct of the parties in the context of the contractual arrangements. Accordingly NAB regards such guidance as providing sufficient flexibility to ensure the unique circumstances of its agricultural customers are taken into account.
- 94 The protections afforded by the obligations imposed on banks discussed above are further strengthened by additional training requirements in the 2019 Code for bank staff to act with sensitivity, respect and compassion for customers in vulnerable situations.
- 95 As such NAB believes there is no need for an additional agribusiness-specific provision in the 2019 Code.
- 96 Practically, NAB notes that the task of fulfilling these obligations as they relate to agricultural customers is aided by the existence of NAB's agribusiness specialist team. These specialists are specifically trained to consider the individual banking needs and business situation of NAB's agricultural customers.

How, and by whom should property be offered as security by agricultural businesses be valued?

- **Is market value the appropriate basis?**
- **Should the possibility, or probability of external shocks be taken to account in fixing lending value? How?**
- **Should the time for realisation of security be taken to account in fixing value? How?**
- **Is the possibility, or probability of external shock sufficiently met by fixing the loan-to-value ratio?**
- **If prudential standard APS 220 is amended to require internal appraisals to be independent of loan origination, loan processing and loan decision processes, when should that amendment take effect?⁶⁹**

97 NAB believes market value is the appropriate basis for the valuation of agricultural businesses. The possibility or probability of external shocks should be taken into account in a bank's credit assessment process for an agricultural business seeking credit. Fixing the loan-to-value ratio, is not, of itself, sufficient to meet the possibility or probability of external shocks. As noted below, NAB's processes recognise these matters.

Valuation of agricultural businesses and amendment of APS 220

98 NAB believes market value, in contrast to a fixed value, is the appropriate basis of valuation for agricultural businesses. Market value allows a bank to understand, and adjust as appropriate, both the level of security held and the appropriate amount of capital necessary to support the loan.

99 The definition and meaning of market value is also well recognised by valuation standards bodies in Australia including the Australian Property Institute (**API**) and the Royal Institute of Chartered Surveyors (**RICS**).⁷⁰

100 On identity of valuer, NAB notes that APRA stated that it intends to adopt the Basel Committee on Banking Commission's requirement that real property valuations are appraised independently from an Authorised Deposit taking Institution's (**ADI**) mortgage acquisition, loan processing and loan decision process.⁷¹ NAB supports, and is working towards, meeting these anticipated changes during the first half of 2019.

External shocks, the time for realisation of security and fixing lending value

101 The possibility or probability of external shocks and the time required to realise security should be taken into account in a lender's credit assessment process for agricultural customers.

102 For example, in relation to the possibility or probability of external shocks, NAB will normally discount (or 'shade') a valuation amount prior to a security value being assigned. This is

⁶⁹ Interim Report, Volume 1, pp 255, 336.

⁷⁰ The definition is: "The estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm's length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion."

⁷¹ Written Submissions of the Australian Prudential Regulation Authority (APRA), fourth round of hearings of the Commission: Experiences with financial services entities in regional and remote communities, undated, at paragraphs [19]-[20].

because a market value is a point in time valuation, not reflective of cyclical factors, and not necessarily reflective of future value.

103 A 30% shading is applied to the value of most broad acre farming properties and a 50% shading is applied to specialist properties (such as orchards or intensive poultry units). Appropriate discount factors are also applied to other agricultural assets such as livestock, cereals and grains.

104 NAB recently reviewed its determination of values for various security types and concluded that its current levels of shading remain appropriate, based on our experience of realised values in distressed sales over a period of years.

105 Further, an agricultural customer's borrowing level should not be determined solely by reference to a valuation amount and the loan-to-value ratio. NAB determines a customer's borrowing level or lending value by reference to a number of relevant factors including:

- (a) Their debt servicing capacity which is determined by an analysis of the customer's cash-flow (including cash-flow cycles) and budgets (stress tested for a range of scenarios including external factors);
- (b) Historical performance of the customer's business during past periods of distress;
- (c) The capability and depth of management;
- (d) Seasonal cycles relevant to that particular business (e.g. the time to raise livestock to marketable condition or to grow and sell crops); and
- (e) The nature and structure of the borrowing facilities to be provided.

106 In relation to the time required to realise security, this is also an appropriate matter to be considered and one that is already factored into NAB's credit assessment. The definition of market value factors includes a 'proper marketing' period and a reasonable selling period depending on the likely potential purchasers, the depth of that market, nature and specialisation of the security, its size and location.

107 In circumstances where a local market may not be active because it is affected by an external shock, valuations may still be able to be undertaken using assumptions and evidence from adjacent or related markets as a guide.

108 If the realisation of the security is expected to be unduly long, then secondary alternatives other than realisation may be preferred by NAB.

Fixing the loan-to-value ratio

109 Fixing the loan-to-value ratio, is not, of itself, sufficient or appropriate to meet the possibility or probability of external shocks. A customer's borrowing level or lending value (including any

buffer for external shocks), should be determined by reference to a number of relevant factors referable to the agricultural business being conducted. These include, among others, its historical performance, capability and depth of management, seasonal cycles of the particular enterprise and its cashflow cycle, and not simply the valuation amount and loan-to-value ratio.

- 110 As noted above, a market valuation has multiple purposes – it is for the customer’s benefit (to know the market value of a significant asset), it assists the bank to understand and adjust the value of security it holds and ensures NAB’s compliance with its prudential obligations.

Do asset management managers need more information (such as the cost to the lender of holding the loan) to make informed commercial decisions about management of distressed agricultural loans?⁷²

- 111 NAB considers it best practice for lenders to have in place specialist asset managers with expertise in the agricultural sector. This is NAB’s practice. Since 2005, NAB has had a specialist agribusiness team within its SBS division which allows for the tailoring of individual strategies in respect of agricultural customers. These SBS specialist bankers have regard for a wide range of circumstances, including climatic, seasonal and economic factors and circumstances unique to agricultural lending.⁷³ Such specialist asset managers do not necessarily require additional information as contemplated by this question in every case.
- 112 When an agricultural customer is referred to SBS, an agribusiness specialist will work with the customer to put in place a strategy to address the issues faced by that customer. The ultimate objective is, wherever possible, to rehabilitate the loan, repatriate the customer to the relationship banker and maintain the relationship with the customer.⁷⁴ Generally, more than 75% of customer loans (including agribusiness loans) have been repatriated to the customer’s banker after being referred to SBS.⁷⁵ This indicates that in the vast majority of cases the members of the SBS team have sufficient information to achieve the ultimate objective.
- 113 In those limited cases where the loan cannot be repatriated, in order to comply with prudential requirements, the SBS specialist will undertake an estimated realisable value analysis of the security and assess whether NAB is likely to recover the outstanding principal debt and interest (including default interest).
- 114 In the minority of cases where the loan cannot be repatriated, a number of options for the customer are considered, including a refinance, a form of settlement involving the sale by the customer of certain assets, or as a matter of last resort, enforcement.
- 115 NAB does not consider that its SBS specialists need more information (including the cost to the lender of holding the loan) to make those informed commercial decisions, in circumstances where non-performing loans represent a very small proportion of NAB’s overall

⁷² Interim Report, Volume 1, pp 255, 336.

⁷³ See Exhibit 4.112, Witness statement of Ross McNaughton, 18 June 2018, [49].

⁷⁴ See Exhibit 4.112, Witness statement of Ross McNaughton, 18 June 2018, [52].

⁷⁵ Transcript, Ross McNaughton, 29 June 2018, 3573.

portfolio (e.g. on average, only 1.2% of NAB's agricultural customers have had a facility in default in the last decade).⁷⁶ Given that, the relevant SBS agribusiness specialists will focus on the information available as to the particular customer's circumstances and work with that customer to see if any of the options aside from enforcement, is achievable.

- 116 If the proportion of non-performing loans represented a significantly higher proportion of its overall portfolio, NAB's SBS specialists would need (and would be expected to have) further information on its cost of holding the loan, given the increased likelihood that the approach taken would have a material impact of NAB's overall capital position.

Are there circumstances in which default interest should not be charged?

- ***In particular, should default interest be charged to borrowers in drought-declared areas?***
- ***If it should not, how, and where, is that policy to be expressed?***
- ***Should the policy apply to other natural disasters?***⁷⁷

- 117 NAB considers that there are circumstances where default interest should not be charged:

- (a) To customers impacted by drought or other natural disasters; and
- (b) 12 months after a loan is in monetary default.

Not charging to customers impacted by drought or other natural disasters

- 118 As the Interim Report noted, on 23 July 2018 NAB announced it would no longer charge default interest for agricultural customers in drought declared regions who were suffering hardship and behind on their payments. This followed discussion of the issue at the fourth round hearings of the Commission. NAB recognised that agricultural customers suffering from long-term drought are under heightened levels of stress, and the continued imposition of default interest for these customers can add to their stress.
- 119 NAB also considers that after a Government declaration of an area or event as being a natural disaster, default interest should no longer be charged to customers impacted by that declared natural disaster. Accordingly, NAB will extend the application of its recently announced policy on drought to all customers impacted by drought, and other natural disasters (such as bushfires, floods, cyclones, earthquakes).
- 120 While NAB's policy on drought assistance is currently principally communicated to customers via its website, NAB considers that a policy relieving customers of default interest in these circumstances should ultimately be reflected in its standard form business lending contracts with customers. Accordingly, NAB intends to amend its standard form business lending contracts to reflect this policy.

⁷⁶ See Exhibit 4.112, Witness statement of Ross McNaughton, [31].

⁷⁷ Interim Report, Volume 1, pp 256, 336.

Other changes for loans in monetary default

- 121 As the Interim Report notes, default interest can grow quickly.⁷⁸ As time goes on, it becomes increasingly likely that any default interest applied will not be paid and that the bank will not be able to meet the ultimate objective of rehabilitating the customer. In those circumstances, NAB considers that default interest should no longer be charged to agricultural customers (and other customers whose lending is governed by NAB's standard form business lending contract) 12 months after the loan is in monetary default. (This reflects the period of time by which NAB would ordinarily expect a loan to be rehabilitated, if that were to occur or the path to rehabilitation to become clear.) NAB will make this change by way of amendment to the terms of its standard form business lending contracts. NAB is currently in the process of determining how best to ensure existing customers receive the benefit of this change. NAB will also implement a process to conduct a formal review of any loans 6 months after it is in monetary default to determine the likelihood of rehabilitation, at which time default interest may no longer be charged and the customer will be informed that is the case.
- 122 Overall, if default interest is not charged in those circumstances, NAB believes it will ensure greater fairness for customers, consistency in their experience, while still acknowledging the additional risk and allowing for the partial recovery of additional costs which NAB incurs when a loan becomes impaired.
- 123 In addition, NAB acknowledges that there is a need for greater clarity for our customers about how default interest is applied. We are undertaking further work on this and whether it would be appropriate to place a cap on default interest.

Should there be a national system for farm debt mediation?

- ***If so, what model should be adopted?***⁷⁹

- 124 NAB supports the introduction of a national system for farm debt mediation through the introduction of a uniform Farm Debt Mediation Act. Whilst the *Farm Debt Mediation Act 1994* (NSW) (**FDMA NSW**),⁸⁰ represents the best current example of farm debt mediation legislation, NAB is of the view that creating a national system would present an opportunity to:
- (a) Identify the best practice components of each existing Act; and
 - (b) Consider other approaches, including other alternative dispute resolution processes which might assist the parties to reach a resolution.
- 125 A national system for farm debt mediation would allow:

⁷⁸ Interim Report, Volume 1, p 254.

⁷⁹ Interim Report, Volume 1, pp 256, 337.

⁸⁰ NAB notes that following a recent thorough review by the NSW Government, the FDMA NSW was amended earlier this year, amongst other things, to broaden the scope of the Act, facilitate exchange of information between parties and provide a right of internal review of decisions of the State administering body.

- (a) A more consistent approach to mediations nationally, including a consistent approach so that customers with properties in or across multiple jurisdictions do not have to engage with multiple and different pieces of legislation;
- (b) The consolidation of concepts and definitions which, in turn, would allow agricultural customers to be provided with more consistent and consolidated information;
- (c) A consolidated approach to any subsequent review of changes to the national system; and
- (d) The introduction of farm debt mediations in states that currently have no legislative system at all, including Western Australia and Tasmania. While Western Australia currently has a voluntary scheme, a national legislative scheme would provide consistency for agricultural customers and banks.

126 Although NAB supports the introduction of a national system, NAB is of the view that there is merit in State bodies charged with the administration of rural affairs (such as the Rural Assistance Authority in NSW and the Queensland Rural and Industry Development Authority in Queensland) continuing to be responsible for administering a national scheme. State based bodies have the advantage of having detailed knowledge of State based issues and being more accessible (geographically) to agricultural customers.

Should lenders be required to offer farm debt mediation as soon as an agricultural loan is impaired (in the sense of being more than 90 days past due)?⁸¹

- 127 NAB is a long-term supporter of farm debt mediation and supports the introduction of a uniform Farm Debt Mediation Act. However, NAB does not believe that lenders should be required to offer farm debt mediation as soon as an agricultural loan is impaired (in the sense of being more than 90 days past due).
- 128 NAB recognises that early engagement is important when agricultural customers face difficult financial circumstances. It is also important to have sufficient flexibility to engage in a range of ways and deal with the individual circumstances of the customer experiencing financial difficulty.
- 129 In practice, this approach involves one or more face-to-face meetings between NAB and the agricultural customer facing financial difficulty and their financial and/or legal advisers. NAB commits to offer to meet with customers, face-to-face, within 30 days of their agricultural loan becoming 90 days past due. At this point, NAB also sees merit in the customer obtaining some professional financial assistance from an accountant or a rural financial counsellor. NAB can provide some financial assistance toward the cost of that advice, if the customer is unable to meet the cost themselves.

⁸¹ Interim Report, Volume 1, pp 256, 337.

- 130 At a practical level, at 90 days past due, the bank and the customer will not usually have a complete understanding of the underlying reasons for the financial distress. To impose a farm debt mediation at this stage, may accelerate the adoption or imposition of final outcomes unfavourable to one or both of the customer and the bank. This could be avoided with the passage of time and continued communication between the bank and the customer. That is so particularly in circumstances where farm debt mediation is often viewed as a measure of last resort and when rehabilitation is no longer an option.
- 131 In most cases, the overlay of a formal mediation process at this stage also imposes additional cost, time and formality, and often adds an adversarial element, to the ongoing relationship between the bank and the customer. Introducing these factors into the relationship between banker and customer at a relatively early stage is not necessarily in the interests of either party.
- 132 NAB also has in place policies which allow customers to engage in negotiations when financial difficulties arise as a result of unforeseen temporary causes. These policies mean that the introduction of a requirement for a farm debt mediation to occur automatically after a loan becomes 90 days past due is not required in order for a customer to be able to engage with NAB in an efficient and effective way.
- 133 For these reasons, NAB believes the imposition of farm debt mediation at an early stage (i.e. as soon as the agricultural loan is 90 days past due) would not be of benefit to either the customer or the bank.

REMOTE COMMUNITIES

Bank policies and procedures for Aboriginal and Torres Strait Islander customers

- 134 NAB is committed to helping address the financial inclusion of Indigenous Australians, including those in remote areas. NAB's commitment has been shown through our previous Reconciliation Action Plans (**RAP**). Guided by NAB's Indigenous Advisory Group, NAB has been developing its next RAP, due to be released in early 2019, with priorities of economic participation, employment, and improving the bank's cultural understanding and intelligence. NAB's next RAP will continue to ensure policies, procedures and practices continue to strengthen the financial inclusion of Indigenous Australians, including those in remote areas, where barriers have been shown to be amplified. As an example, in partnership with other banks and the ABA, NAB participates in the remote fee-free ATM agreement.
- 135 To better support employees to improve their cultural understanding and to build awareness of NAB's products and services for Indigenous customers, NAB will release updated cultural awareness training in 2019. This training will include information on cultural and linguistic barriers encountered by some Aboriginal and Torres Strait Islander people and support NAB's communications with Indigenous customers to be culturally appropriate. NAB is also in the

process of conducting research, in partnership with the Centre of Social Impact and First Nations Foundation, which examines the financial resilience of Aboriginal and Torres Strait Islander Australians. This research will assist in identifying barriers and areas of action to better support increased financial resilience amongst Indigenous Australians.

***Are banks' identification requirements appropriate for Aboriginal and Torres Strait Islander customers? If they are, are those policies sufficiently understood and applied by staff?*⁸²**

- 136 AUSTRAC's 2016 updates to identification requirements for Aboriginal and Torres Strait Islander people allows financial institutions to accept alternative identification documents from Indigenous Australians, which reflects certain social and cultural sensitivities and realities. NAB has adopted these AUSTRAC guidelines that outline appropriate forms of identification, and continues to improve customer-facing employees' understanding of these requirements.
- 137 NAB's AUSTRAC identification policies are: available to customer-facing employees across a number of training programs and online portals; included on internal systems designed to provide 'real time' support to employees for product related customer enquiries; and included in Indigenous cultural awareness e-learning for products and services relevant to some Indigenous customers.
- 138 While NAB believes AUSTRAC's updated identification requirements assist in financial inclusion of remote Indigenous customers, NAB will continue to work with communities and the industry to ensure they remain appropriate.

***Do banks take sufficient steps to promote the availability of fee-free accounts to eligible customers?*⁸³**

***Should informal overdrafts be allowed on a bank account if credits to the account are only, or are substantially, by payment of Centrelink benefits?*⁸⁴**

- 139 NAB's Classic Banking account is a fee-free account available to **all** customers. A fee-free everyday transaction account ensures all customers have access to basic financial services which is fundamental in supporting an individual's financial inclusion and resilience. While information about this product is available on NAB's website, NAB will continue to ensure that the existence and availability of this product is communicated to all our customers.
- 140 In relation to whether informal overdrafts should be allowed on accounts where credits on the account are all, or substantially by way of, the payment of Centrelink benefits, NAB is of the view that there may be circumstances where informal overdrafts are of benefit to customers, where the customer has demonstrated an ability to repay the overdraft.
- 141 There are also some circumstances where not allowing an account to overdraw by a small amount causes customer detriment (for example when a third party direct debit is dishonoured

⁸² Interim Report, Volume 1, pp 265, 338.

⁸³ Interim Report, Volume 1, pp 265, 338.

⁸⁴ Interim Report, Volume 1, pp 261, 265, 338.

that organisation may charge the customer a penalty, or when a low-income customer faces an unexpected outlay).

- 142 NAB monitors customer accounts in order to assess whether a small informal overdraft limit is appropriate (and available) for each customer, including by reference to the deposits made into the customer's account.
- 143 In order to ensure customers do not suffer undue financial stress by inadvertently overdrawing their account, a customer's overall account history is also assessed regularly to see whether it is reasonable to allow informal overdrafts on their account and to determine by how much the account can be overdrawn.
- 144 NAB does not charge dishonour fees on any of our consumer personal accounts. This practice ensures customers, including those in remote and very remote areas do not suffer from additional bank fees if direct debits are applied to accounts with insufficient funds.

REGULATION AND THE REGULATORS

*Is the regulatory regime too complex? Should there be radical simplification of the regulatory regime?*⁸⁵

- 145 As the hearings of the Commission have identified, financial services entities and ADIs, including NAB, are subject to a large number of legislative and regulatory requirements supervised by multiple regulators. NAB recognises that the existing regulatory framework is robust and designed to ensure, amongst other objectives, that Australia's financial sector is sustainable, stable and efficient and protects consumers. While the regulatory framework is comprehensive, NAB is of the view that aspects of the current regulatory regime could and should be enhanced through simplification.
- 146 Various features of the existing regulatory framework contribute to its complexity including:
- (a) The length of the applicable laws (e.g., Corporations Act and the NCCP Act), noting the Commission's observation, by way of example, of the increase in length of the Corporations Act by 178% since 1981;
 - (b) The volume of compliance obligations, with over 700 different sources leading to a total of approximately 3700 unique obligations (e.g., there are in excess of 70 obligations in the NCCP Act that NAB must comply for a home loan, as well as additional obligations including privacy and Know Your Customer laws);
 - (c) The duplication or repetition of some norms of conduct (e.g., a myriad of different misleading or deceptive conduct provisions) and processes (e.g. the need to provide duplicative or similar data to multiple regulatory agencies);

⁸⁵ Interim Report, Volume 1, pp 299, 339.

- (d) A focus on prescriptive rules over principles in many cases (e.g., financial product disclosure requirements in Part 7.9 of the Corporations Act);
- (e) Multiple layers of regulation (i.e., statute, regulation, guidelines, policy statements and industry codes of conduct like the Code); and
- (f) Conflicting or different regulatory approaches and priorities, including to the same subject matter, with clarity of the regulatory mandate across agencies a matter on which the Council of Financial Regulators can and should maintain a focus.

147 Whilst NAB recognises simplification would not be a straightforward exercise it would welcome a thoughtful and constructive effort to simplify the existing regime by addressing the above features that contribute to complexity and placing greater emphasis on a core set of principles of the kind referred to in the Interim Report. NAB is of the view that this would lead to better outcomes for the industry, through more effective compliance, enhanced consumer understanding and greater efficiency in the use of resources.

148 A by-product of the complexity of the existing regime is that aspects of NAB's internal policies designed to respond to that regime in turn have also become unduly complex. NAB's own goal of clarity and simplicity in its internal policies would be assisted by simplification of the existing regulatory regime. NAB is actively working to simplify its internal policies and processes to ensure that they are better understood, easier to apply and calculated to produce better compliance and customer outcomes. This is an area of substantial effort and focus.

149 NAB's aim to simplify its policies supports NAB's new vision, pursuant to which the need to be 'simpler and faster' is a key component. More broadly, NAB anticipates that simplification of the regulatory regime would enhance compliance and outcomes across the sector.

If the recommendations of the Enforcement Review are implemented, will ASIC have enough and appropriate regulatory tools?⁸⁶

150 The ambit of ASIC's responsibilities has continued to increase in recent years, with ASIC now administering 11 pieces of legislation. As ASIC's responsibilities have increased, ASIC has called for greater powers to enable it to carry out its functions.

151 There are a number of initiatives underway to broaden the range of regulatory tools available to ASIC. For example, the Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Power) Bill 2018, currently before Federal Parliament, will provide ASIC with new powers, including product intervention, the ability to request information and to issue stop orders in relation to suspected contraventions of the new regime. New civil and criminal penalties will also be available to ASIC.

⁸⁶ Interim Report, Volume 1, pp 299, 340.

- 152 The Department of Treasury's *ASIC Enforcement Review Taskforce Report* in 2017 also made a range of recommendations designed to enhance ASIC's enforcement capabilities. The Federal Government agreed (or agreed in principle) to the recommendations in the report but deferred consideration of some initiatives until the Commission was complete. NAB notes that on 24 October 2018, the Government introduced the Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Bill 2018 to Federal Parliament.
- 153 A number of these recommendations, if implemented, would enhance ASIC's enforcement capability, including by aligning the consequences for misleading ASIC in Australian Financial Services and credit contexts, increasing ASIC's banning powers for individuals performing roles in financial services and strengthening the civil and criminal penalties for corporate and financial sector misconduct.
- 154 Further, NAB recognises the importance of self-regulation of entities and the value in ensuring that the system as a whole is not reliant on regulatory enforcement alone. By reorientating their focus, financial services entities can contribute to ensuring that the adequacy of regulatory tools is a less acute issue. As referenced at paragraph 147 above, NAB is committed to simplifying its policies and procedures to assist in this effort.

***Are ASIC's enforcement practices satisfactory? If not, how should they be changed?*⁸⁷**

***Should ASIC's enforcement priorities change? In particular, if there is a reasonable prospect of proving contravention, should ASIC institute proceedings unless it determines that it is in the public interest not to do so?*⁸⁸**

- 155 ASIC's enforcement priorities and practices are principally a matter for ASIC. NAB does not consider litigated outcomes are necessarily better than negotiated outcomes, or vice versa; rather, both are legitimate regulatory enforcement tools available to ASIC with different advantages and disadvantages available depending on the circumstances. In NAB's experience, the practice of engaging with regulators to achieve negotiated outcomes has, in many cases, delivered more positive and faster outcomes for customers than a singular pathway of enforcement through litigation could have done. At the same time, NAB acknowledges that, in some cases of misconduct, litigated outcomes can provide more effective deterrence and understanding of the applicable law and that those are relevant considerations for the regulator to weigh in determining appropriate enforcement action.
- 156 There may be genuine and compelling public interest reasons as to why ASIC elects to utilise one of a range of its enforcement outcomes, rather than moving directly to the commencement of proceedings. The High Court of Australia has recognised that avoiding lengthy and complex litigation frees courts to deal with other matters and frees the investigating officers of regulators to turn to other areas of investigation.⁸⁹ To similar effect, the

⁸⁷ Interim Report, Volume 1, pp 299, 340.

⁸⁸ Interim Report, Volume 1, pp 300, 340.

⁸⁹ *Commonwealth v Director, Fair Work Building Industry Inspectorate & Ors* (2015) 258 CLR 482 at 496.

Court has also recognised that a regulator’s decision to settle a claim may also advance the public interest in the enforcement of the regulatory regime more effectively and efficiently than the continued prosecution of the claim.⁹⁰

157 ASIC should be able to determine which matters it will enforce through court proceedings and the best way to achieve outcomes which are compatible with, and further, the public interest. Similarly, the regulator should also be able to determine which matters it will address through other regulatory tools and what is the most effective use of its resources. In this regard, NAB acknowledges the recent comments by ASIC Deputy Chair Daniel Crennan QC before the Parliamentary Joint Committee on Corporations and Financial Services that “the appetite for EUs, and certainly any form of EU which contains a mere acknowledgement of our concerns, is far diminished.”⁹¹

Are APRA’s regulatory practices satisfactory? If not, how should they be changed?⁹²

158 In the same way as noted in relation to ASIC above, and subject to APRA’s enabling legislation, APRA’s regulatory approach and practices are matters for APRA.

159 APRA is a prudential regulator and ASIC is a conduct regulator. As set out in the Interim Report, “APRA’s chief focus is governance and risk culture”,⁹³ as well as its central task being to “prevent failure of the financial system and to prevent failure of entities within the system.”⁹⁴ In contrast, “ASIC’s focus is on conduct regulation.”⁹⁵ Any examination of the regulatory practices of both regulators should bear these important differences in mind.

160 In NAB’s view, APRA’s regulatory practices are currently appropriate to achieve APRA’s banking, insurance and superannuation regulatory supervision objectives. Australia’s twin model of financial regulation has largely been considered successful and has now been adopted by other countries including the UK, New Zealand and South Africa.

Are APRA’s enforcement practices satisfactory? If not, how should they be changed?⁹⁶

161 NAB considers that APRA’s enforcement priorities are a matter for APRA. APRA, like ASIC, has the ability, as an independent regulator, within the scope of its enabling legislation, to determine its regulatory strategy, approach and priorities, including the extent to which it will enforce potential breaches within its responsibility.

⁹⁰ *Commonwealth v Director, Fair Work Building Industry Inspectorate & Ors* (2015) 258 CLR 482 at 523.

⁹¹ Transcript, ASIC Deputy Chair Daniel Crennan QC before the Parliamentary Joint Committee on Corporations and Financial Services, 19 October 2018, 32.

⁹² Interim Report, Volume 1, pp 300, 340.

⁹³ Interim Report, Volume 1, p 270.

⁹⁴ Interim Report, Volume 1, p 270.

⁹⁵ Interim Report, Volume 1, p 270.

⁹⁶ Interim Report, Volume 1, pp 300, 340.

Does the conduct identified and criticised in this report call for reconsideration of APRA's prudential standards on governance?⁹⁷

162 NAB does not consider that APRA's prudential standards should be reconsidered. APRA's prudential standards on governance set out in CPS 510, which are compulsory for APRA regulated entities, are consistent with good governance practices for ASX listed entities in other industries. For example, many of APRA's governance standards are consistent with the ASX Corporate Governance Council, Corporate Governance Principles and Recommendations which all ASX listed entities must report against on an "if-not why not basis" in their corporate governance statement.⁹⁸

Having examined the governance, culture and accountability within the CBA group, what steps (if any) can APRA take in relation to those issues in other financial services entities?⁹⁹

163 As the Commission will be aware, NAB, like other financial institutions, is currently undertaking a written self-assessment of its frameworks and practices in relation to governance, culture and accountabilities which will be provided to APRA by 30 November 2018.

164 It is anticipated that APRA will review the self-assessment and then respond to, and liaise with, financial services entities in regard to their findings.

ENTITIES: CAUSES OF MISCONDUCT

Conduct Risk

What are banks doing to meet the danger of conduct risk?¹⁰⁰

165 Measures to address conduct risk are recognised by NAB as an important aspect of managing risk for financial services entities, particularly as poor customer outcomes diminish trust and can have significant financial or non-financial impacts. Accordingly, conduct risk is one of eight material risks identified by NAB in its risk management strategy.¹⁰¹ NAB is acutely conscious that conduct risk is an area of risk requiring increased attention, further work and improvement.

166 NAB is currently changing its approach to conduct risk, including how the term is defined. The executive leadership team at NAB considers conduct risk to be "the risk that any action will result in poor outcomes for customers". This is a simpler formulation of the current approach to conduct risk and one which is likely to be formally adopted by the board.

⁹⁷ Interim Report, Volume 1, pp 300, 340.

⁹⁸ ASX Corporate Governance Council, Corporate Governance Principles and Recommendations, 3rd ed, p 3.

⁹⁹ Interim Report, Volume 1, pp 300, 340.

¹⁰⁰ Interim Report, Volume 1, pp 324.

¹⁰¹ Risk Management Strategy dated September 2017 (NAB.005.054.0092).

- 167 Earlier this year, NAB commenced a review of its approach to conduct risk. When completed, the revised approach is expected to be simpler, more values driven, to more clearly set out conduct risk expectations and measurement and promote greater focus on the customer.
- 168 NAB is working to formally adopt this revised approach in early 2019, taking into account the outcomes and learnings identified from the APRA self-assessment into governance, culture and accountabilities; the self-assessment undertaken pursuant to Prudential Standard CPS 220 on risk management; and the findings of the Commission.
- 169 At this stage, as part of the new approach to conduct risk the following actions will be undertaken:
- (a) The revised conduct risk framework will be formally adopted and implemented;
 - (b) The risk management framework will be amended to clearly articulate the accountabilities for conduct risk management, monitoring and oversight;
 - (c) Group wide reporting of conduct risk against risk appetite will be implemented; and
 - (d) Training workshops will be provided to staff to support the Group in understanding and implementing the revised framework.
- 170 NAB recognises it is important that its approach to conduct risk be regularly reviewed, and reviewed by the right people within NAB, to incorporate emerging risks when necessary. NAB is giving consideration to how external benchmarking of the revised conduct risk framework will be performed and utilised.
- 171 NAB anticipates that the increasing use of data analysis and emerging technologies will also better enable industry participants to identify, understand and manage many types of risk, including conduct risk. These mechanisms will supplement traditional mechanisms for identifying and managing conduct risks and will include the use of predictive models and artificial intelligence, as well as data relating to loan delinquency and bad and doubtful debts, to pinpoint potential instances of conduct risk.
- 172 NAB recognises that the culture of an entity, and in turn the conduct of its employees, can be influenced by a range of factors. The extent to which employees are held accountable for their conduct and the approach taken to remuneration are two such factors. As set out in our responses relating to remuneration, incentives and BEAR below at paragraphs 173 to 186, work has been undertaken in relation to NAB's remuneration practices. This is in recognition of the link between good culture and promoting remuneration practices that deter conduct that does not result in good customer outcomes.

Remuneration and incentives

What more should be done to implement the recommendations of the Sedgwick Review?¹⁰²

- 173 The intent of the Australian Bankers' Association 2016/2017 Retail Banking Remuneration Review (**Sedgwick Review**) was to rebuild public confidence in the banking industry and reduce the risk of poor customer outcomes.¹⁰³ The Sedgwick Review makes principle-based recommendations. This leaves open the possibility that the approach and the implementation may be inconsistent across institutions, but still within the intent of the Sedgwick Review recommendations. NAB considers that a more consistent approach across institutions would better serve customer interests.
- 174 NAB has implemented all the recommendations of the Sedgwick Review as they relate to retail bank staff. We have also made changes to the executive remuneration framework, announced on 19 September 2018 and that are beyond the scope of the Sedgwick Review. All changes have been to enhance our focus on customers, including the mandating of customer objectives in every balanced scorecard, which reduces the focus on financial performance. NAB's priority now is to ensure that the changes made are operating as intended, including that the changes are driving the right customer, risk and cultural outcomes.
- 175 The process of reviewing the effectiveness of the changes will be complete by the end of December 2019, after the end of NAB's performance year. NAB is open to an independent review and sharing the results of its internal review with the relevant stakeholders.

Should any bank employee dealing with a customer be rewarded (whether by commission or as part of an incentive remuneration scheme) for selling the client a product of the employer? That is, should any 'customer facing employee' be paid variable remuneration?¹⁰⁴

- 176 NAB has made progressive changes to the way it rewards employees over the past decade. Effective 1 October 2018, the vast majority of customer facing roles have moved to a plan that rewards for performance against a balanced scorecard of metrics covering Customer, Risk, Financial and Transformation performance over a longer period and payable annually. This has meant that from this financial year, almost all of NAB employees are on balanced scorecards that pay annually (rather than monthly, quarterly or bi-annually).
- 177 NAB participates in a competitive market where variable reward is an established component of remuneration packages. In order to attract and retain talent from others sectors, NAB needs to ensure its remuneration remains competitive. Accordingly, NAB is undertaking the process of refining variable reward practices to ensure that they meet the principles outlined (balanced, long term and focused on customers). It is critical that they remain competitive given the talent we need to attract and retain.

¹⁰² Interim Report, Volume 1, pp 324, 341.

¹⁰³ Exhibit 4.57, 19 April 2017, Retail Banking Remuneration Review at p 2.

¹⁰⁴ Interim Report, Volume 1, pp 324, 341.

- 178 NAB's approach to variable reward has changed, informed by a range of matters, including the Sedgwick Review. Variable reward is increasingly about rewarding sustainable performance that is in the customers' best interests. The timeframe over which reward is earned has increased; the amount of reward deferred and timeframe of deferral has increased.
- 179 Given NAB's vision is to be Australia's leading bank, trusted by customers for exceptional customer service, we need to continually assess whether our remuneration practices are driving this focus. We have moved many customer facing roles from product related incentive plans to the balanced scorecard approach to determining variable reward. NAB recognises that this is a significant cultural shift.

If the answer is either 'no' or 'some should not' what follows about incentive remuneration for managers or more senior executives? If more junior employees should not be remunerated in this way, why should their managers and senior executives?¹⁰⁵

- 180 NAB considers that the direct people leaders of customer facing employees who sell products should be on the same reward structure as their reports because they direct the day to day behaviour of NAB's customer facing employees. This is the case at NAB, whereby the leaders of customer facing employees are on the same balanced scorecard approach to determining reward.
- 181 At a certain level of leadership (i.e., in NAB's organisational context, Executive General Managers and the Executive Leadership Team), the role is organisationally focused and strategic in its intent and outcomes. NAB considers that variable reward can and should continue to play a part in relation to those roles. This is reinforced in the Banking Executive Accountability Regime (**BEAR**) which incorporates an element of reward that can be assured over a longer period to ensure sustainable decisions.

The BEAR

Is the Banking Executive Accountability Regime relevant to the intersections between remuneration and culture more generally than in its application to particular senior executives?¹⁰⁶

- 182 The culture of an organisation is shaped by a range of factors. The level of demonstrated accountability of senior executives and the approach taken to reward are two relevant influencers.
- 183 BEAR amended the *Banking Act 1959* (Cth) to strengthen the responsibility and accountability framework for the directors and most senior executives of ADIs. Pre-BEAR, NAB had a four year deferral period on the long term incentive component and one and two year deferral periods on a portion of the short term incentive component of its executive remuneration, as

¹⁰⁵ Interim Report, Volume 1, pp 324, 341.

¹⁰⁶ Interim Report, Volume 1, pp 325, 341.

well as malus arrangements. In implementing BEAR, NAB has enhanced its deferral scheme to be in excess of the statutory requirements. In addition to 60% of our CEO's variable reward being subject to a four year deferral period, this position has been extended to apply to all other accountable persons that are eligible for variable reward (with two exceptions).^{107, 108}

184 For NAB, BEAR is one of the factors that facilitates:

- (a) Delineation and clarity of accountability both at an executive level and across our organisation more broadly; and
- (b) A demonstrable link between performance and reward that encourages a range of behaviours and discourages others.

185 In facilitating the above, NAB considers BEAR has broader relevance to employee behaviour beyond the scope of senior executives (or accountable persons).

Should the BEAR be altered?¹⁰⁹

Should the BEAR be extended in application?¹¹⁰

186 NAB considers that BEAR should apply to all prudentially regulated financial institutions, not just those controlled by an ADI.¹¹¹ BEAR has operated for large ADIs since 1 July 2018 and will not come into operation for small and medium ADI until 1 July 2019. Given this implementation timing, NAB considers it otherwise too early to assess whether any changes to BEAR are desirable.

Intermediaries

Is it desirable to prescribe that some or all of those who are not employees of banks, but deal with bank customers, must act in the interests, or the best interests, of the client?¹¹²

In particular, what duty, if any, should a mortgage broker owe to the prospective borrower?¹¹³

187 In addressing this question, NAB's focus is on brokers. Introducers have a substantively different role to other intermediaries, such as brokers, as they have no role in the provision of credit or the decision to provide credit. Accordingly, NAB addressed the position of introducers separately at paragraphs 6 to 8 above.

188 A broker is, by nature of the role, a conduit between a lender and consumer. The Interim Report states that: "Generally, if the intermediary owes a duty to the borrower it will be the

¹⁰⁷ As defined by section 37BA of the Banking Act 1959 (Cth)

¹⁰⁸ The current statutory requirement for other accountable persons other than the CEO is 40%, which will be applied to the exceptions.

¹⁰⁹ Interim Report, Volume 1, pp 325, 341.

¹¹⁰ Interim Report, Volume 1, pp 325, 341.

¹¹¹ As per NAB's submission to Treasury dated 29 September 2017 on the BEAR exposure draft and explanatory materials

¹¹² Interim Report, Volume 1, pp 325, 341.

¹¹³ Interim Report, Volume 1, pp 325, 341.

statutory obligation to determine only whether the proposed loan is unsuitable”.¹¹⁴ NAB observes that this obligation is a negative test and is not plainly connected to customer outcomes.¹¹⁵

189 In response to ASIC’s 2016 *Review of Mortgage Broker Remuneration* (‘ASIC Report’) and the third party recommendations of the Sedgwick Review, the Combined Industry Forum (CIF)¹¹⁶ proposed a ‘customer first duty’ among other reforms.

190 The proposed ‘customer first duty’ would apply to mortgage brokers and is expressed as follows:

I place your interests first in my dealings with you. In doing so, I will ensure I recommend a loan which is appropriate (in terms of size and structure), is affordable, applied for in a compliant manner and meets your set of objectives at the time of seeking the loan.

191 The ‘customer first duty’ incorporates the ‘good customer outcome’ definition proposed by the CIF. That definition outlines a standard that would hold the industry to a higher obligation than the ‘not unsuitable’ obligation. This includes:

- (a) Appropriate size and structure of the loan;
- (b) Meeting the customer’s stated requirements and objectives;
- (c) Affordability for the customer; and
- (d) Whether the loan is applied for in a compliant manner in accordance with responsible lending requirements.

192 Broadly, these elements direct a broker to ensure that the customer does not obtain a type of loan they do not need. In order to do so, the broker must actively engage with the customer to ascertain their circumstances and requirements.

193 NAB will look to implement these reforms as soon as is feasibly possible, noting that the industry is currently committed to this occurring by the end of 2020. NAB believes that the proposed ‘customer first duty’ establishes a positive, objective, measureable test and, if appropriately applied, will result in an outcome that is in the interests of the customer.¹¹⁷ The ‘customer first duty’ has content that is connected to customer outcomes and is capable of being readily understood. In that sense, it is preferable to any general ‘best interest’ test that does not clearly set out the requirements to satisfy the duty.

¹¹⁴ See Interim Report, Volume 1, p58.

¹¹⁵ See NCCP Act, ss 115 – 118.

¹¹⁶ The CIF comprises lenders, aggregators, 5 peak industry bodies, Choice consumer group and brokers.

¹¹⁷ In contrast to, for example, the “best interests” obligation – see the discussion in the Interim Report at pp 139-140 (“the legislative provisions emphasise process rather than outcome”).

Governance

194 NAB believes that compliance with the 'customer first duty' must be tested and monitored (as described further below). Moreover, there should be a mechanism for enforcement. The CIF reforms give effect to these priorities by proposing a governance framework and an industry code as outlined below.

Governance Framework

195 The governance and oversight reform proposed by the CIF outlines a framework to identify, among other things, bad practices and poor customer outcomes. In particular, the framework outlines 'key risk indicators' (**KRIs**) to act as triggers that allow testing for potentially poor customer outcomes. These KRIs include:

- (a) The percentage of a portfolio as interest only;
- (b) When customer payments are in arrears greater than 90 days;
- (c) 'Switching' products within the first 12 months;
- (d) A poor post-settlement outcome as indicated through survey feedback; and
- (e) The quality of the customer needs assessment and application, where there are deficiencies in requirements and objectives documentation.

196 These will be reported by each lender at broker level to the aggregator. This level of reporting will provide the lender, aggregator and broker the detail required to assess the outcomes customers are receiving across different lenders. Where there is sufficient evidence of poor customer outcomes associated with a particular broker, the broker would be removed from the industry. The governance framework will take time to develop and establish, with CIF timeframes indicating completion by the end of 2020.

Industry code

197 The intent is to ultimately establish an ASIC-approved code for all participants in the mortgage industry. The code will form the basis for the monitoring and enforcement of the 'customer first duty' and codify the governance and reporting framework.

198 We are aware that this could take some time. Accordingly, NAB supports a proposal that an industry code be implemented in the meantime (while ASIC approval is sought).

Is value based commission, paid to the broker by the lender, consonant with that duty? How is a value based commission consistent with acting in the interests, or best interests, of the client?¹¹⁸

199 Value based commission (that is, payment of an upfront and trail commission) is the established remuneration model for the broker market. This standard model is a variable cost

¹¹⁸ Interim Report, Volume 1, pp 325, 342.

model that remunerates the broker only once a home loan has been settled. This means brokers' services are affordable to customers (as they are paid by the lender), and creates a level playing field for competition for smaller and more geographically dispersed lenders.

200 However, NAB recognises that this standard model has the potential to create conflicts of interest, as highlighted by the ASIC Report.¹¹⁹

201 There are two primary ways in which these conflicts may become evident. Firstly, a broker could recommend a loan that is larger than the consumer needs or can afford in order to maximise their commission payment. This may also involve recommending a particular product or strategy to maximise the amount that the consumer can borrow, such as through the choice of an interest-only loan. ASIC described this conflict as a 'product strategy conflict'.¹²⁰ Secondly, a broker could be incentivised to recommend a loan from a particular lender because the broker will receive a higher commission, or 'volume bonus' even though that loan may not be the most appropriate loan for the consumer. This could also take the form of soft dollar benefits. ASIC described this as 'lender choice conflict'.¹²¹

202 The CIF reform package proposed changes to remuneration to address both forms of conflicts outlined in the ASIC Report, which NAB has acted on.

203 Effective from 12 November 2018, the upfront broker commission for NAB home loans will be calculated based on the drawn loan balance, not the total approved facility amount, and net of any offset facility, thereby reducing the incentive to recommend an inflated loan size. In addition, volume and campaign bonuses have been eradicated from the mortgage broker market. It should also be noted that NAB has never paid volume-based bonuses in respect of residential mortgages. NAB is also confining rewards or benefits of a non-cash nature ('soft dollar benefits') including changes to tiered servicing, conferences/professional development events, and entertainment and hospitality, to reduce the potential for both 'lender choice conflict' and 'product strategy conflict'.

204 NAB recognises that the current changes being implemented do not entirely remove the potential conflict of a commission-based model. NAB also accepts that if there is a policy-based reason to move away from value based commissions entirely, the industry should reconsider a commission based model – for example, if it were determined (on evidence) that customer outcomes are jeopardized by value based commissions. NAB also believes there needs to be greater clarity on what services are provided for the payment of upfront and ongoing remuneration. However, NAB does not consider that appropriately structured value based commissions *per se* affect customer outcomes.

¹¹⁹ ASIC, *Report 516: Review of Mortgage Broker Remuneration*, March 2017, p10.

¹²⁰ *Ibid*, p10; see also written submissions of the ASIC in response to the first round of hearings of the Commission, p2.

¹²¹ *Ibid*.

- 205 Against the background of enhanced protections for borrowers referred to earlier in the response to this question, NAB believes any further changes would need to be carefully considered. In particular, the risk of unintended consequences would need to be taken into account. For example, if commissions were replaced with a fee for service paid by the consumer, this would potentially increase direct costs to consumers to access broker channels, disadvantage smaller lenders and those without branch networks, and weaken competition. A flat lender fee might result in brokers servicing a narrow band of customers (for example, those with simple needs) and would not address lender-choice conflict. Base commissions paid on Loan Value Ratio (**LVR**) may exclude high LVR lending (for example, to first home owners) and could encourage greater use of guarantees to reduce LVRs.
- 206 NAB believes that the current changes, when coupled with the 'customer first duty' and governance framework, create a more robust and enforceable model, with a viable mortgage broker industry that provides significant competition in the mortgage market. Competition is essential to ensuring not only that customers have a choice of the channel from which they source the mortgage but that smaller lenders without significant physical presence have a distribution channel, therefore providing borrowers with access to these lenders. Nevertheless, we note, and NAB will actively support, the CIF intent to re-examine all potential remuneration models to better address potential conflicts and the risk of poor customer outcomes.
- 207 It should be noted NAB remains committed to implement Sedgwick Review recommendation 18 which requires "banks adopt approaches to the remuneration of Aggregators and Mortgage Brokers that do not directly link payments to loan size and reflects a holistic approach to performance management...".¹²²

Should an aggregator owe any duty to the borrower?¹²³

Again, are the remuneration arrangements for aggregators consonant with that duty?¹²⁴

- 208 Whilst the aggregator has a role to play in ensuring that brokers carry out their duties, NAB does not consider that any duty to the borrower should be imposed on an aggregator. An aggregator does not have any direct relationship with the borrower. It makes no credit decision. Rather, the aggregator provides services to the broker and acts as a conduit to the lenders on behalf of the brokers. Moreover, the aggregator makes no decision in relation to any individual customer. It is the broker and, ultimately, the lender who have a direct relationship with the customer and it is therefore appropriate that each owes a duty to the customer. The aggregator is in an entirely different position.
- 209 Moreover, NAB considers that adding a third layer of duty to the lending process would not ultimately lead to better outcomes for the borrower. Indeed, it will add complexity and may

¹²² Exhibit 4.57, 19 April 2017, Retail Banking Remuneration Review at p 10.

¹²³ Interim Report, Volume 1, pp 325, 342.

¹²⁴ Interim Report, Volume 1, pp 325, 342.

create uncertainty about where the responsibility to the borrower lies. It may also give rise to inconsistency of obligations owed to the borrower. That is not to say that aggregators do not play an important role – they do – and that role will be reflected in the governance and oversight framework proposed by the CIF (including receiving reports from lenders of KRIs) which will enable assessment of customer outcomes across lenders for individual brokers.

***Should intermediaries be subject to rules generally similar to the conflicted remuneration prohibitions applying to the provision of financial advice?*¹²⁵**

***If some or all intermediaries should owe the customer a duty to act in that customer's interests, or best interests, is it enough to prescribe the duty and direct 'management' of conflicts between interest and duty?*¹²⁶**

210 As stated above, NAB has agreed to industry changes that focus on the importance of ensuring customers obtain a loan which is appropriate for their needs in terms of size and structure, is affordable, is applied for in a compliant manner, and meets the customer's objectives at the time of seeking the loan. Further, NAB supports the extension of the industry's proposed 'good customer outcome' requirement to also incorporate a 'conflicts priority rule' as a 'customer first duty'.

211 NAB has set out above why it considers a 'customer first duty' as proposed by CIF to be preferable to a general 'best interest' test. Similarly, for the reasons outlined above, NAB does not consider it necessary for rules similar to the financial advice conflicted remuneration provisions to apply to brokers.

¹²⁵ Interim Report, Volume 1, pp 326, 342.

¹²⁶ Interim Report, Volume 1, pp 326, 342.